ACCOUNTING
THEORY AND PRACTICE

A TEXT-BOOK FOR COLLEGES AND SCHOOLS OF BUSINESS ADMINISTRATION

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To My Father and Mother

AN APPRECIATION OF THEIR STEADFAST INTEREST IN MY WORK

INTRODUCTION

There are many things, in the writing of a book, which can be said only in the foreword. First, the "raison d'etre" of the book may require an explanatory word. Second, it may not be out of place to discuss some of the many points of academic controversy; such as the difference between bookkeeping and accounting; as to whether accounting is an art or a science; the various theories of debit and credit, etc. Finally, consideration may be given to the need of a knowledge of accounting on the part not only of those preparing for business but also of those expecting to enter any of the professions.

With regard to the first point, it may be said that although there are available excellent *treatises* on accounting, the author feels that the field is rather barren of textbooks for the use of college students. This book is an effort to supply this need for students of first-year accounting.

As to the second point, suffice it to say that the author does not know the difference between bookkeeping and accounting and doubts whether there is any except in popular parlance. As to whether accounting is an art or a science, he believes that there is an art and also a science of accounting, the former resting upon the principles established by the latter. The necessary brevity of this introduction does not permit an adequate discussion of all the theories of debit and credit.

As to the necessity for a knowledge of accounting on the part of both business and professional men, it should suffice to direct attention to the inclusion of accounting in the courses of all schools of business administration and to the tendency on the part of many professional schools

to offer in their curricula courses in general accounting. The author believes the time will come when a fundamental knowledge of accounting will be required of practically all candidates for a degree from a college or university.

It is to be remembered that accounting instruction is not standardized; it is still in a formative stage. A period of three years of graded work has received fairly general recognition as the minimum requirement for professional study, but the content of the three years' work is not entirely uniform, nor are the order and the method established in which the subject matter should be presented, nor the amount to be offered in each of the three years.

In some schools a knowledge of "bookkeeping" is a prerequisite to entrance upon the study of "accounting"; in others the dry bones of theory are separated from their application in practice, although the tendency seems to be to treat the two, theory and practice, in the one course. Again, in some schools, an effort is made to cover in the one year all of the so-called accounting theory, while in other places there is a growing conviction that the subject matter is too broad for adequate presentation in the time usually allotted to the first year's work. In other places an attempt is made to differentiate between accounting as presented for the general student and accounting as offered to the one expecting to make it a vocation. It is being recognized, however, that both classes must have equal training in the essential fundamentals of the science. A diet of denatured accounting will deprive the general student of training, a lack which may seriously handicap him.

Most students on entering college do not have a knowledge of bookkeeping nor should it be required of them. Those few who do have such a knowledge, for the most part, understand only a partial application of debit and credit and not the fundamental principles on which rests

the whole structure of accounting. This book is designed to meet this existing condition and will be found equally adapted to either class of students. The subject is developed in such a way that the student knowing something of bookkeeping has little or no advantage over the one without such knowledge. This book has been written for the use of students in our colleges and universities desiring a *first* course in accounting.

The present volume gives the scope of the work in accounting offered in the first year of the School of Business of Columbia University, and is an effort to mark out and define the portion of the whole subject which can be handled effectively in one year's time.

There is a real demand for a one-year course which will treat the subject in a general way and give a brief view of the entire field. The author believes, however, that accounting in its broadest sense is just beginning to receive the consideration which it deserves and that more and more is recognition being given to the necessity of a *thorough* knowledge of its principles and their application, for effective work in all lines of business activity. Accordingly, the material in this first volume is not presented to meet the demand of the casual reader or of the student seeking a bird's-eye view of the entire field, since much of the subject matter is reserved for presentation in a second volume which the author hopes to have ready in the course of another year. In that will be taken up a more detailed treatment of the balance sheet in connection with its problem of valuation; various aspects of the corporation and of the income statement, not adequately handled in this volume; together with some miscellaneous topics, including forms of special statements, branch accounting, sinking funds, and other similar subjects.

The method of approach as given in this volume is

perhaps not orthodox but it has seemed that the student, given an understanding of the purpose which the accounting records are to serve, will be able to make that record with real intelligence instead of by rule of thumb. Accordingly, the balance sheet and the profit and loss statement are presented first, as the goal towards which all record-keeping looks. The student is taught to analyze business facts and conditions from the very beginning. He is then led, step by step, through the use of non-technical terms, into the ledger, where he sees the way in which the data which he has been using are summarized. The books of original entry are next explained and the method by which the information is classified as it is brought onto the books. Finally, the business papers and documents which constitute the source of all entries are described.

It has been found that the student who has no knowledge of bookkeeping can thus acquire rapidly and intelligently a facility in its technique with no lost or wasted effort. Instead of laboring through many "simple" transactions and spending much duplicated effort, he is taught fundamental principles and their application right from the beginning, after which these principles are correlated and tied up in a complete whole. The process may be somewhat discouraging to the student at times and he may ask for a simpler diet, but in the end he has a surer and more fundamental grasp of the subject than could have been obtained otherwise in the same time.

The first half of the book is devoted principally to the work outlined above. The second half gives a broader and more intensive development of many of the subjects treated but incidentally up to that point. Here the order of arrangement is not so important. The guiding thought has been to present first the principles needed by the student in his practice work, and then to deal with the more detailed

applications of these principles regardless of the fact that this has at times necessitated a break in the continuity of treatment of some subjects.

As to the general content of texts on accounting, it may be said that it is always necessary to include a treatment of many points of the law, of business organization, and of finance. This is so because accounting is so intimately connected with all business activities that the subject cannot be fully understood and applied unless it is based on a fair knowledge of business practice. These subjects should be kept to a minimum and effort has been made to do so.

A word of explanation may be in order with regard to the practice work for the student. The material for this is presented at the end of each chapter and is intended as an application of the principles developed in that chapter or in preceding chapters. The various "Problems" given present disconnected material and bear no relation to each other; the "Practice Data," on the other hand, contain connected matter for record in blank books and relate to a business whose record the student is keeping.

One rather long set of practice data is included in the present volume because it is felt that in some quarters we have got away too far from the long set, the work having been cut up into such short periods that the student does not get adequate drill in the making of the record nor a proper perspective as to the volume of transactions during a fiscal period. Nor with these short sets does he get a realistic basis for the calculation of depreciation, bad debts, and other similar items. However, care has been exercised not to overburden the student with the drudgery of too much of this material, only enough being given to insure facility in the application of principles.

For the use of those instructors who desire to offer additional practice work, or desire an opportunity to vary

the problems or substitute detached problem work for a portion of the formal sets, a collection of classified problems is given in the second appendix. In gathering these problems together the author has drawn freely from many sources and desires here to acknowledge the kindness of David Friday and R. J. Bennett in permitting the use of problems prepared by them.

There remains the pleasant part of the foreword—the acknowledgment of the kind helpfulness of many whose best thought and effort have been given without stint in the production of this book. Acknowledgment is here made of helpful criticism and service from H. T. Scovill, of the University of Illinois; R. A. Klahr, of Colorado College; I. G. Flocken, of the University of Pittsburg; F. H. Elwell, of the University of Wisconsin; D. W. Morton, of the University of Oregon; Ben Morris and C. W. Collins, of the University of Denver. J. E. Trelevan, of the University of Texas, and Earl A. Saliers, of Yale University, gave much help by their painstaking review and freely given suggestions. Particularly does the author acknowledge indebtedness to the Columbia staff of instructors in first-year accounting, F. P. Baltz, H. F. Seward, R. T. Bickell, C. M. Neubauer, E. M. Barber, and K. L. Baker.

During the period of preparation of this material, Professor R. H. Montgomery, in a life full of many activities, found time to lend a guiding hand and give ever-ready encouragement. Both for this and for valuable criticism on many points, and especially in fixing the emphasis of the book, the author takes this opportunity of publicly acknowledging his debt to him.

R. B. KESTER.

New York City,
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*Illustrative Problems or Practice Data accompany each chapter except Chapter I.

Accounting—Theory and Practice

CHAPTER I

HISTORY AND DEVELOPMENT OF ACCOUNTING

Antiquity of Accounting

Accounting or the keeping of records is undoubtedly as old as civilization itself. Wherever trade and credit were introduced, some method of keeping a record must have been employed. With the rise of powerful chiefs and organized government, the necessity for keeping account of many and varied complex transactions must have provided the means of doing so. Little record has been left by ancient peoples whereby a very definite idea can be formed as to their methods, but sufficient data have been discovered to prove the existence of a highly organized trade and to point out some of the tools and means by which that trade was conducted.

Business Progress in Babylon

Three or four thousand years before our era, Babylonia was a flourishing state. The code of Hammurabi, a ruler of Babylonia, 2285 B. C. to 2242 B. C., shows that the partnership form was known; also the relation of principal and agent; drafts and checks were common; legal decisions had been recorded covering contracts, conveyances by deed, bonds, receipts, inventories, sales, and accounts of all sorts; customs and ferry dues were collected; highway tolls

and water rates were imposed. The records of two banking and money-lending firms, the Sons of Egibi of Babylon and the Marashu Sons of Nippur, have come down to us. The method of keeping their records was by means of sun-baked tablets or slabs, one-half by three-quarters inches in size, written on the front, back, and sometimes on the edges; others were as large as nine by twelve inches. Also carefully prepared registers for the state made record of the ownership of property as the basis of taxation. All these records, it seems, were kept by scribes, who were presumably the only ones who could make the record.

Egyptian Records

In Egypt, accounts were kept on papyrus. We find here very careful record of the revenues and disbursements of the state. Taxes were usually payable in kind, necessitating the building of granaries and depositaries of various kinds for the storing of the receipts—treasure houses, as it were. The tax payer bringing his grain was stopped at the first entrance to give a record of his payment, and again at the point where formal delivery was made, where a second record of the amount was written down. This method of auditing by means of duplicate but distinct records cannot in some instances be improved upon even today.

Concerning the methods of record-keeping by the Persians, Phoenicians, and Carthaginians, we know little definitely. Trading both by land and by water was active and some method of account-keeping was presumably employed.

Accounting in Ancient Greece

In Greece a strict accounting was required of all public officials. The records were kept by treasurers, sub-treasurers. clerks, and checking clerks, but even these seem to

have been unable to prevent peculation and graft which were very prevalent although severely penalized. Each officer upon giving up his office was required to render an accounting of the funds intrusted to him. Publicity was secured by engraving the accounting on stone and exposing it to public view. The Greeks borrowed much from the East. They developed a crude clearing-house system, made loans, discounted notes, etc.

Roman Records

In early Rome the father of a family kept records of his receipts and payments in a sort of blotter or memorandum record. Every month these were transferred to a more carefully kept register, entry in which, if made with the consent of a debtor, was sufficient basis for legal suit or civil obligation. The bankers used a similar register and seem to have made use of a third book in which accounts with customers were set up, on the one page that for which they were indebted to the banker and on the opposite page that with which they were credited. Periodically a balance was figured and might be demanded in cash by the customer or the account might be continued. Checks seem to have been used by the wealthy, though cash payments were usual.

The system developed by the state in this early period introduced a new feature by means of which disbursements were safeguarded. The official intrusted with the funds had no authority for disbursing them. That was intrusted to a separate and distinct body which issued orders on the treasurer, proyiding him with a voucher, at an accounting time, for the disbursements made by him. Cicero holds up to scathing satire one Verres, a public official and grafter, for the meagerness of his accounting; and in another case criticizes one attempting to base an action on memoranda.

mere scraps of papers, in contravention to established usage. Both these instances point to the keeping of very carefully prepared records of transactions between persons. In the early empire, under Augustus, a system of provincial and district treasuries was employed with a strict accounting to the central treasury. It seems that as a basis for the levy of taxes, a crude form of budget showing the needs of the imperial household, the army, etc., came into use. Under the later empire this district system of government, the levying and collection of taxes, became very highly organized. Eight of the ten or twelve central offices or departments of control were devoted to accounting.

The Medieval Retrogression

After the overthrow of Rome and before the building up of a new civilization almost from its foundations, for a time attention was centered on the future spiritual life rather than on the affairs of the material world, and this may account for the loss of these records of the Romans. However, the Pope as the head of a vast and growing organization, required records of various sorts and Charlemagne had an elaborate system of accounting for income and expenditure and required detailed reports from all his subordinates.

Early English Accounting

In England the earliest system of accounting on record was that of the exchequer, established about the time of Henry I (1100-1135). The basis for this accounting was the Domesday Book which showed all taxable estates in the country. From this the treasurer's Great Roll—the Pipe Roll—was made up and each sheriff was intrusted with the collection of his portion. Twice every year he rendered an account. At the first accounting he received

the half of a tally ~~stick with notches~~ showing the amounts. The other half of the tally stick with its corresponding notches was retained by the treasurer. Upon his next accounting, the sheriff's tally stick was turned in as evidence of the payments already made and must exactly fit into the half retained by the treasurer.

The Rise of Double Entry

In the revival of trade during the twelfth and thirteenth centuries, Italy played ~~a leading~~ part. Here was unquestionably the beginning of double-entry bookkeeping. When, is not known with exactness. A Florentine banker in 1211 kept accounts with clients and memoranda of other transactions, but there was no attempt to bind them together into a systematic whole. A French firm, Freres Bonis (1345-1359), used its books for the purpose of making up a list of debtors and creditors, thus showing its position as to persons. This evidences a systematic, though limited, use of books for showing position. At this time, some systems were quite voluminous and elaborate, one Italian firm opening in one year eleven books—five white, two black, and one each red, orange, green, yellow. In Genoa in 1340, a double-entry ledger was in use. It shows a "pepper" merchandise account debited with expenses and credited with receipts, the balance being transferred to "profit and loss." A similar system used in Venice and known as the Venetian method was very neatly and carefully kept. In these early books Roman numerals were quite generally used, the courts requiring that only books using the Roman notation would be accepted as evidence. Books were not often balanced, one set showing a balance after nine years, another thirteen, and another only after twenty-six when the accounts were transferred to a new volume.

Ancient Double-Entry Bookkeeping

In 1494 at Venice a monk, Luca Paciolo, a celebrated mathematician, brought out a book entitled, "Everything about Arithmetic, Geometry and Proportion." A recent American translation with commentaries by J. B. Geijsbeek entitled "Ancient Double-Entry Bookkeeping" has been made. At the end of his treatise on arithmetic, Paciolo includes a dissertation on bookkeeping comprising thirty-six chapters called "Reckonings and Writings." He makes no claim to originality, stating that his work was a summary of existing practice. Some of his statements and methods are interesting. He states the purpose of bookkeeping to be the furnishing of information with regard to assets and liabilities. He bases his opening entries on a list or statement of assets and liabilities. The system described provides for the use of three books, a memorial, a journal, and a quaderno.

The memorial is a day book or blotter, its use being necessitated by the chaotic condition of the currencies then in use. The actual moneys received and paid were entered here and later transferred, reduced to a common medium of values, to the journal where a formal debit and credit were given, from which in turn they were posted to the quaderno or ledger. In the journal the date was at the middle of the page on a line reserved for it, only one money column was used, and the posting folios for debit and credit were shown as a fraction. In the ledger, the folio index was always of the contra ledger account and never of the original journal entry. The merchandise transactions were usually of the single venture type, each transaction being charged with its expenses and credited with its income; the balance was transferred to Profit and Loss which held a very prominent place. Methods of detecting errors were given. Paciolo's treatise gave very few illustrations.

Early Text Books

A book for teaching by means of examples was published in 1525 by one Giovanni Antonio Taglienti. In England, Hugh Oldcastle, a teacher of arithmetic and bookkeeping, brought out a translation of Paciolo, with some omissions not applicable to English methods, in 1543. In 1635 Richard Dafforne, an accountant, published the "Merchant's Mirrour, or directions for the perfect ordering and keeping of his accounts; framed by way of Debitor and Creditor, after the (so termed) Italian manner." His book went through several editions, evidencing a demand for the work.

Since then the literature has been rather profuse, written mostly by self-styled accountants, teachers, and writing experts. Some were quite ambitious, one by Robert Hamilton of Edinburgh, 1777, illustrating systems for shopkeepers, tradesmen, land stewards, and farmers. He classifies accounts as personal, real, and fictitious. His books he calls a waste book (i.e., a blotter), a journal, and a ledger. He shows the ledger closed by journal entry and a balance sheet with assets on the left and liabilities on the right, exactly counter to current English practice. In the ledger was an inner column for foreign moneys; there were shown forms for a suspense book for bad debts; a cash book; charges of merchandise; a petty cash book; a postage ledger; bill books; and a balance ledger for customers. It remained, however, for one Edward Thomas Jones, of Bristol, to capitalize his selling as well as his accounting ability when he accepted prepaid subscriptions for a ten-column ledger system invented by himself but never used.

Development of the Ledger Account

The *form* of the ledger account was very slow in developing. At first it was merely historical or narrative, a

statement of transactions, receipts and payments, debits and credits, in chronological order, one underneath the other on the same page. It seems that the account as now stated was not known in ancient times. Egyptian accounts about 100 B. C. show some classification, receipts being grouped together followed by the disbursements, with the balance carried forward for the next day. The development of a separate money column was slow. An English royal household account for 1299-1300 shows a narrative of receipts and disbursements with a money total column on the right entirely free from narrative. The form of the account up to the seventeenth century was usually as above, the money column on the right, the first entry being the opening balance, followed by the receipts, and these by the disbursements.

During the latter part of the fifteenth century the charge-discharge form was used by the Lord High Treasurer of Scotland. The account opened, "I charge myself with:" followed by the itemized estate entrusted to him and all revenues. It closed with, "I discharge myself with," followed by a statement of the moneys lawfully expended and, at the end, the uncollected revenue. The several pages of this report were footed but not carried forward page by page. At the close a recapitulation was made arriving at the net moneys to be accounted for. The double form of account as now known must have come into use about the thirteenth century in Italy and reached England by way of Holland, as was usually the case with Italian business methods. Roman numerals were used until 1673, at which time the Arabic came into use and a regular money column was introduced. In Italy the Arabic notation had come gradually into use considerably earlier.

Before leaving the subject of the early accounts, it may be interesting to note that often items in officials' ac-

counts were not approved by the "awdytowris" appointed to pass on them. An early auditor's certificate reads: "Approved the foresaid accompts in all the heads and articles thereof (errors and mistakes always excepted)"—a form which some today might like to employ.

Organizations of Accountants

Organizations of accountants have been in existence but little more than fifty years. Almost from the start there have been those who devoted their entire time to professional accounting, if we can believe some of the titles which they were wont to assume. In England in 1721, an accountant made an investigation of the South Sea Company in connection with its exploitation and reported his findings. This seems to be the first report on record and it does not cast much credit on the fair-mindedness and disinterestedness of the accountant, who evidently was in the employ of the men whose manipulations he was investigating. In 1799, Holden's triennial directory of London gives eleven names and firms as accountants. The nineteenth century, with its rapid expansion and extension of trade due to improved methods of manufacture and means of reaching markets by easy transportation and communication, created a demand for the services of scientifically trained men of the highest caliber and largest vision to account for the intricate and complex transactions involved and to establish the necessary control for the proper management of such vast undertakings. The first formal organization of accountants was in Edinborough in 1854 when the Society of Accountants was incorporated by royal charter; in Glasgow in 1855; and in Aberdeen in 1867. The Institute of Accountants was formed in London in 1870 but was not chartered till 1880 at which time it secured the exclusive right to use the letters F.C.A. or A.C.A., respectively Fellow

or Associate of the Institute of Chartered Accountants. In connection with this Institute a students' association was organized from which upon the passing of severe examinations members can enter the ranks of the Institute. On the Continent, while the art of bookkeeping has developed rapidly and attained a high proficiency, accountancy has not attained the standing and following which it has in England where certain statutes such as the Companies Clauses Consolidation Acts of 1845, the Companies Acts of 1862 and 1900 and various bankruptcy acts, have fostered accountancy and provided for the employment of accountants. In Ireland, The Netherlands, France, and Italy organizations have been established on a somewhat similar basis.

Organizations of Accountants in the United States

In the United States an organization was effected in New York in 1887 somewhat along the lines of the English societies under the name of the American Association of Public Accountants. The first legal impetus was given to the profession in 1896 when an act passed the legislature in Albany authorizing the regents of the state university to grant upon examination the privilege of using the letters C.P.A. Other states followed and in 1905 a federation of the various states was taken over into the American Association of Public Accountants which until recently was the national body. At the annual meeting of the Association in New York, September, 1916, they determined, though still retaining their own charter, to go as a body into the American Institute of Accountants, a new society organized a short time previously under federal charter. The new society has direct control over its membership, which is divided into two classes, members and associates, and, just as in England, admission to it will be based upon examination.

Contrary to the history of accountancy in England, there has been little legislation here to foster the growth of the profession until somewhat recently. The corporation and income tax laws have increased the claims upon the accountants' professional services, and some state laws have tended in the same direction. The growing appreciation by the banks of the value of the certificate of the public accountant when attached to a borrower's statement of financial condition; the demand for skilled accountants in public utilities work; the value of the training to a public office-holder; the favorable attitude of the membership of the Federal Reserve Board and Federal Trade Commission in recognizing the value of correct accounting methods; and more and more the increasing opportunities for the exercise of abilities of the highest order in the private field—all these things make the profession one of the most attractive to the young man of today.

CHAPTER II

PROPRIETORSHIP

Relation of Accountancy to Economics

We sometimes define Economics as the science of wealth, meaning thereby that body of classified knowledge relating to wealth in the aggregate. Under our present-day political and social systems, the ownership of wealth is very largely private. Furthermore, the division of labor as industry is now organized has been carried to an extreme point. Because of these facts, the present varied organizations for producing wealth to meet human needs and desires have given rise to an urgent need for some effective means of keeping record of all the activities involved in such human endeavor.

The effort of every individual engaged in industry is to increase wealth. To secure that result, he labors to extract the raw materials from nature, to shape and pattern them in such fashion as to supply the wants of his fellowmen, and then to distribute them by means of markets and exchanges so as to secure for himself the greatest possible returns for his effort. As competition along the various lines of human activities has become keener, the margin of this return per unit of product has lessened, and the producer has had to increase his volume of business to secure his customary gains. To become a producer it has been necessary for him to use the saved wealth of former periods to pay his expenses for materials, labor, management, etc., during the period of production. He must consume wealth in order to produce wealth. After his product has been finished he must seek the best market for its exchange. This

necessitates the use of a complex system of transportation facilities. Finally, during the whole process of production and exchange there has been constantly before him the distribution of the estimated returns from his effort among the several parties engaged in the production of his article. And more and more as it has been necessary to make this distribution on the basis of estimated returns, has the need, the absolute necessity, for an accurate record of the costs of the activities and processes all along the line become apparent to him. The record, then, of the value of the rights of the various parties to this product, is the special field of work assigned to accountancy.

Relation of Accountancy to Law

The determination of what are the rights of the several parties to the creation, exchange, and ultimate consumption of a product is the field of law, more particularly business law. The determination, by means of its records, of the value, the amount, or the size of that right is the province of accountancy. Thus is Accountancy inseparably related to Economics and Law. No one of them can progress far without the help of the others. All being related to, and arising out of, the manifold field of human endeavor, their progress, their development, is dependent upon, and limited only by, the progress of that endeavor.

The Fundamental Problem of Accountancy

The effort of each one, therefore, being the increase of wealth, the first problem of accountancy is the determination of how much wealth is invested in a given enterprise and what ownership or proprietorship exists at given periods of time, so that by comparison the increases and decreases may be known. When by this means accurate information is had, an intelligent plan of action may be adopted to remedy

the ills of business that are shown, or to increase any phases of profitable activity. Accordingly, we say that proprietorship and its changing values are the basic problems of accountancy.

Definition of Terms

Before proceeding to a definition or determination of proprietorship, it will be necessary to understand what is meant by the terms "assets" and "liabilities." The root idea of the word "assets" is sufficiency. Specifically, assets are the "entire property of all sorts, of a person, association, or corporation applicable or subject to the payment of debts." Similarly, liabilities are those things for which a person, firm, or corporation is bound; one's pecuniary obligations or debts. We define proprietorship, then, by the equation:

$$\text{Assets} - \text{Liabilities} = \text{Proprietorship}$$

Or as the balance sheet usually shows:

$$\text{Assets} = \text{Liabilities} + \text{Proprietorship}$$

Some writers, in an endeavor to simplify the statement, treat "assets" as positive goods, and "liabilities" as negative goods. Since, from an algebraic viewpoint, the combination by addition of positive and negative quantities results in a quantity which measures the excess of one kind over the other, the equation is sometimes stated algebraically:

$$\text{Positive Goods} + \text{Negative Goods} = \text{Proprietorship},$$

that is, Goods = Proprietorship. This though simple in appearance, may be confusing in content and must be understood only to mean that net goods (the excess of assets over liabilities) represent proprietorship. In this work we will use the equation as given in the first forms.

The Proprietorship Equation Illustrated

By way of illustration, take the following simple statement:

On January 1, 1916, Jas. T. Runyon started business with an investment of $5,000 cash.

Here the proprietorship equation becomes:

Assets (Cash $5,000) = Proprietorship ($5,000),

for Runyon has made himself liable to no one as yet. But after securing the materials and equipment needed for starting his business, he finds his status to be as follows:

He has store furniture and fixtures purchased from Lowell Bros. for $500, of which he paid $250 in cash, the balance still owing. He bought a stock of groceries for $2,500 from Reid Murdock & Co. on ten days' time.

So far, his proprietorship has not changed; he is worth the same as before, though there is needed a more complex statement to show it—somewhat as follows:

Assets		—	Liabilities		=	Proprietorship
Cash	$4,750		Lowell Bros. claim	$250		
Furniture	500		Reid Murdock claim	2,500		
Merchandise	2,500					
	$7,750	—		$2,750	=	$5,000

After conducting his business for six months, Runyon finds that his activities have comprised the purchase of a delivery equipment for $300; sale of goods amounting to $6,000; the payment of $1,000 for rent, clerk hire, and advertising; and sundry purchases of stock in trade and other items as needed. He finds that, as a result of the above, he has $1,000 cash now on hand; that customers owe him on account $3,000; that his stock of goods still on hand is worth $2,100; that he owes creditors $1,000 for

goods bought and his clerks $50 for services rendered; and that he has no other liabilities.

It is seen that as the number of assets and liabilities increases, the above method of showing them becomes awkward and cumbersome; therefore, using the same fundamental equation, we make the following tabulation to determine and show his proprietorship:

Assets

Cash	$1,000.00	
Customers	3,000.00	
Merchandise	2,100.00	
Furniture	500.00	
Delivery Equipment	300.00	
Total Assets		$6,900.00

Liabilities

Creditors for Merchandise	$1,000.00	
Clerks for Services	50.00	
Total Liabilities		1,050.00

Proprietorship

Net Worth		$5,850.00

This method of showing the proprietorship equation is called a "Financial Statement" or "Balance Sheet."

It may be interesting to note that further analysis of the above information will disclose also the amount of his purchases and how much he paid his creditors. Take the transactions involving cash and we find that he had $5,000 to start with and received $3,000 from sales, in all $8,000. He bought furniture and delivery equipment for $800, and paid expenses of $1,000, in all $1,800, leaving a balance of $6,200 to be accounted for. $1,000 cash is still on hand,

so he must have paid creditors $5,200. Since he still owes creditors $1,000 for goods bought, his purchases must have been in all $6,200.

Problems

(*Assignment for Chapter II*)

1. On June 30, 1916, H. S. Homer has the following property: cash $1,675.29; merchandise $15,683.71; furniture and fixtures $1,275; delivery equipment $836; stocks and bonds bought for investment at $5,360; accounts owing him: Jno. Peterson $69.50; Pete Hewitt $125; Chas. Jackson $742.69; Earl Jones $147.31; J. T. Squires $790.42; I. M. Axman $63.74; and S. P. Palmer $75. He owes James Bros. $1,250.69, T. J. Stewart & Co. $965, T. Jennings Jinks $4,692.43 for merchandise purchased; and his 60-day note for $1,000 discounted at the bank at 6% is due today. What is his present interest in the business?

2. During the following 6 months he bought goods amounting to $20,000 paying $14,769.25 cash, the balance outstanding on December 31. He paid on account to James Bros. $1,000, T. J. Stewart & Co. $469.31, T. Jennings Jinks $4,500; for expenses of clerk hire $1,500; rent $750; including heat, light, and water service; advertising $60; delivery equipment for repairs $75; deliverymen $600; supplies $150; and general expense $250. He received on old accounts: from Jno. Peterson $50; Pete Hewitt $125; Chas. Jackson $143.72; Earl Jones $147.31; J. T. Squires $600; I. M. Axman $13.74; and he is notified that S. P. Palmer has gone into bankruptcy and that he will pay 33 1/3% of all claims. Cash sales have been $10,763.25 and sales on account to new customers $25,637.52 of which amount all has been collected in cash except $8,769.41 which is now outstanding. Goods now on hand are valued at $12,673.49. He received in dividends and interest from his investments $268. Reckoning wear and tear on furniture and fixtures at 10% per annum and on delivery equipment at 12½%, what is his business worth on December 31, 1916?

3. A railway company has the following assets: cash $32,500; office furniture $975; franchise $300,000; U. S. bonds 6% $30,000; interest accrued on U. S. bonds $900; power house $200,000; construction $502,625; motors and cars $275,000; car barns $18,000. Its

liabilities are notes payable $35,000; accounts payable $12,500; first mortgage bonds $200,000; interest due on same $5,000; second mortgage bonds $250,000; interest due on same $7,500. What is the net worth of the company?

Instructions

Make a careful determination of the assets and liabilities in each of the above problems, and then present solutions according to the form last illustrated in the text.

In Problem 2, the information as to cash receipts and disbursements must be used to determine the present cash on hand and the condition of the old customers' and creditors' balances. Calculate the depreciation for the half-year on furniture and delivery equipment on the values given in Problem 1.

CHAPTER III

TYPES OF BUSINESS ORGANIZATION

Before proceeding with a further discussion of the showing of proprietorship by means of financial statements, the three general types of business organization will be treated briefly, because the manner of indicating proprietorship is dependent to a certain extent on the type of organization. These types are (1) the single or sole proprietorship, (2) the partnership, and (3) the corporation.

The Single Proprietorship

The simplest form of business enterprise is that conducted by a single proprietor. It is well adapted to businesses where the capital necessary for efficient production is small, where the processes are simple and capable of being handled by the average individual, and where the risks are slight. Very few legal obstacles are placed in the way of the individual desiring to go into business for himself, nor is a great deal required of him. In some cases registration and the securing of a license are necessary. The observance of the general laws as to payment of taxes and as to local regulations to protect society from disease and fire is all that is usually expected. Subject to the general restrictions which ordinary business acumen and foresight would place upon an individual, he can enter practically any field of enterprise, has entire freedom and privacy in the conduct of his business, and shares with none the results of his endeavor. On the other hand, these seeming advantages oftentimes prove to be marked disadvan-

tages. As industry the country over is at present organized, many fields of activity, demanding large capital, and many kinds of technical knowledge are closed to the single proprietor. Freedom of action carries with it sole responsibility, and oftentimes the counsel and advice of others would have prevented disasters which sometimes overtake him.

The Partnership

A partnership is "a contract of two or more legally competent persons to combine their money, property, skill, and labor, or some or all of them, for the prosecution of some lawful business and to divide the profits and bear the losses in certain proportions." The essence of the partnership from the viewpoint of a working organization is mutual agency, each partner being the agent of the others, but, within the limitations of the partnership agreement, capable of acting as a principal for the firm. Few restrictions are placed on the partnership other than those placed on the individual. In some localities it is necessary to file in a public office a brief statement of the firm name and the names of the members, in order to secure the right to sue and be sued in the firm name.

The chief advantages of the partnership are obvious—larger capital and therefore access to fields closed to the individual; the combining of the business wisdom, skill, and knowledge of several; the subdivision of duties and therefore the possibility of specialization. While in the view of the business community, the partnership is an entity, a business unit, in the sight of the law it is not so considered, each member of the firm being held liable to creditors for the entire debts of the partnership as if it were his sole business. Of course, if any one member has to pay any of the firm debts, he has a claim against his copartners for contribution. Some of the disadvantages of this type of

organization are the possibility of friction among the partners and consequent delay of action; the extension to the firm of credit based not on the firm property but rather on the total property of the members, and the consequent liability of each partner and his entire private fortune for the debts of the firm.

It should be said before leaving the subject that the partnership agreement should be very carefully drawn to cover in detail the relations of the partners, their duties and their rights, particularly as to sharing in the profits or losses of the firm.

The Corporation

The corporate type of organization is distinguished from the other types discussed (1) by the freedom of each owner from the personal liability for the debts of the business to any greater extent than his stock interest in the business, though frequently in financial corporations, and in a few states for all corporations, his liability is double that stated; (2) by the evidencing of the share of ownership by a formal document called a certificate of stock; (3) by the allowing to each owner a voice in the affairs of the business only to the extent of his stock ownership therein; (4) by the necessity of securing from the proper authorities permission to do business; and (5) by having to comply strictly with the terms of this permit and to submit to certain requirements such as the filing of annual reports, payment of special taxes, and the like.

Owners, or stockholders as they are called, conduct their business through a board of directors elected for that purpose and subject periodically, usually annually, to a review of their management and a new election. In this way the stockholder exercises indirectly an oversight of the business. This remoteness of personal interest and oversight

has been somewhat overcome by electing to the board only those largely interested in the business, and by continuing on the board those whose past ability as managers has been tried and proven. Frequently the board delegates to others hired by it the active management of affairs.

The corporate form of organization has become popular because of the limitation of liability of its owners, because it lends itself well to the accumulation of large funds of capital necessary for the promotion of present large-scale enterprises; and, because, though unwieldy in point of the number of its owners, it has developed a convenient and effective means of centralized control and management.

The Showing of Proprietorship Under These Types

The showing of proprietorship for these three types of organization differs somewhat. The title under which proprietorship is listed in the financial statement is "Capital." In a single proprietorship such title is preceded by the proprietor's name, as shown in the following illustration:

Assets		
Cash	$2,000.00	
Accounts Receivable	5,000.00	
Merchandise	3,000.00	
Furniture and Fixtures	500.00	
Total Assets		$10,500.00
Liabilities		
Accounts Payable	$4,450.00	
Due Clerk	50.00	4,500.00
Proprietorship		
James Runyon, Capital		$6,000.00

In a partnership the showing of capital is not made in one item, but each partner's interest is stated separately at its present value.

Assets		
Cash	$2,500.00	
Accounts Receivable	10,250.00	
Merchandise	8,750.00	
Furniture and Fixtures	625.00	
Total Assets		$22,125.00
Liabilities		
Accounts Payable	$5,465.00	
Notes Payable	1,660.00	
Total Liabilities		7,125.00
Proprietorship		$15,000.00
Represented by:		
James Runyon, Capital	$8,000.00	
Philip Adams, Capital	7,000.00	$15,000.00

In a corporation, proprietorship is shown in the aggregate of the outstanding shares of stock valued at par under the single title "Capital Stock," and, if there is more proprietorship than that indicated by the shares of stock, it is listed separately under the title "Surplus." This method of showing it is prescribed by law and is an effort to inform creditors or those who may be creditors that the corporation has observed the legal requirement not to distribute any of its original capital among the stockholders; hence, the original proprietorship of the corporation must be listed at a fixed figure all the time, and any changes taking place in the proprietorship during the life of the corporation are taken care of separately by the "Surplus" as was indicated above.

Assets

Cash	$1,850.48	
Notes Receivable	1,645.65	
Accounts Receivable	15,285.35	
Merchandise	10,045.94	
Supplies	1,145.37	
Furniture and Fixtures	1,636.97	
Delivery Equipment	1,427.50	
Buildings	8,000.00	
Land	2,600.00	
Total Assets		$43,037.26

Liabilities

Accounts Payable	$5,762.26	
Notes Payable	4,250.00	
Salaries Due but Unpaid	25.00	
Mortgage on Land and Buildings	3,000.00	
Total Liabilities		13,037.26
Proprietorship		$30,000.00
Represented by:		
Capital Stock	$25,000.00	
Surplus	5,000.00	$30,000.00

PROBLEMS

(*Assignment for Chapter III*)

1. Make up three problems, using your own data, to illustrate the three types of business organization.

2. The following shows the financial condition of James Shongood on December 31, 1914: He owns a building costing $5,000; on land costing $1,000; in part payment for which he gave his note secured by mortgage for $3,000. He has machinery valued at $900; loose tools at $150; finished goods on hand $2,500; raw material and partly finished goods $8,325; models and patterns $350; shop furniture $275;

typewriter, safe, office desk, filing cabinet, chairs, etc., in all $150. His bank balance is $525; cash in safe $75; amounts due him from customers on open account $3,967.50, on notes $572.25. He owes creditors on open account $2,572.75, on accepted drafts $543.50; pay-roll earned but not due $150. Due to expansion of his market he needs more capital to take advantage of new opportunities. Accordingly he takes in a partner, Homer Goodwell, who invests cash equal to Shongood's interest in the business, $9,000 of which is used to purchase the plant of a competitor ($1,500 for the ground and $1,600 for the machinery, $250 for tools, $100 for patterns, $500 for shop furniture, and the balance for the building), $5,000 to pay for product on hand which was taken over ($2,000 for finished goods, the balance being for raw materials); and $2,000 for delivery equipment. Show a financial statement for Shongood and one for Shongood and Goodwell.

Instructions

In Problem 1, present the data in the form of solutions according to the illustrations in the text.

In Problem 2, combine with the old assets the values of the new assets acquired before showing them in the financial statement for Shongood and Goodwell. The group names for customers and creditors are "Accounts Receivable" and "Accounts Payable" respectively. Notes due from customers are "Notes Receivable." Notes and drafts due creditors are "Notes Payable." List "pay-roll earned" as "Accrued Pay-roll" with the liabilities. Calculate the cash balance. List the mortgage note as "Mortgage Payable."

CHAPTER IV

THE FINANCIAL STATEMENT

Its Purpose and Use

The financial statement is designed to show the financial condition of a particular business at a given time. As previously illustrated, it marshals the assets in one list or schedule and the liabilities in another. The difference between the totals of the two schedules gives the present or net worth of the business. It is not sufficient in making a financial statement to give simply the figures of proprietorship or net worth, but schedules must be drawn up to show the items that make up that net worth. From the viewpoint of an investor, a prospective purchaser, a banker to whom application for a loan has been made, or a concern considering the advisability of extending credit on a bill of goods purchased from them, it makes all the difference in the world to know that a particular business having a net value of $10,000 has assets of $15,000 and liabilities of $5,000; or to know that its assets are $260,000 and its liabilities are $250,000. The ratio of total assets to total liabilities holds a large place in the determination of questions raised above by the investor, purchaser, banker, or creditor. Furthermore, the character of the assets and of the liabilities has an important bearing. If the assets are in properties for which there is not a ready market and the liabilities are claims which mature soon and will have to be met, the situation is unfavorable. If there are large values invested in easily salable assets; if there is a large balance of cash on hand after meeting current claims and providing

for those which will soon mature; if other liabilities are of a more permanent nature, such as mortgages or long time notes not requiring immediate attention—the situation might show evidence of too large a capital, or of inefficiency in management as shown by the failure to invest some of the surplus cash in properties from which some return might be secured.

Its Content and Subdivisions

It will therefore be seen that the financial statement must serve a very definite purpose or purposes, and that to serve these purposes it must have a very particular content. Any statement which lists assets and liabilities and shows their difference as proprietorship is a financial statement. The form or the method of scheduling has nothing to do with the fact of its being a statement of financial condition, but the statement which, because of its form, gives the most information for the purpose for which it was drawn is, in comparison with all others which might be drawn, the best statement. Hence, keeping always in mind as a functioning or guiding principle the use to which the statement is to be put, the form, the method of showing and marshalling the items, is of great importance. For this purpose we shall classify assets and liabilities roughly into two groups, current and fixed, whose connotation has been sufficiently indicated on the basis of ease of convertibility into cash, or salability, for the assets, and relative urgency of meeting the claim for the liabilities. Therefore, in any presentation of financial facts, the data should be shown grouped into the two classes of current and fixed, both for the assets and for the liabilities, so as to render easy comparison possible. In this way a basis can be secured for judging of the efficiency of the management in making provision for meeting the claims against the business as they fall due and in

having as nearly as possible a proper balance between the two groups. While there is not entire uniformity at present in the matter of precedence of either group, the weight of authority would indicate the placing of current assets first, followed by the fixed assets, and a similar marshalling of the liabilities.

Its Titles, Principal and Group

Various terms are in use to indicate the main groups of items in the financial statement and as names for the statement itself. "Balance Sheet," "Statement of Resources and Liabilities," "Statement of Assets and Liabilities," are frequently used instead of "Financial Statement." Within the statement itself, Resources is used as an alternative title with Assets; and Net Worth, Present Worth, and Net Assets are used for Proprietorship. For the present the forms shown will be used with the substitution of the term Net Worth for Proprietorship. The title of a statement should be full; it should include the name of the business enterprise and date, and would appear somewhat as follows:

SHONGOOD & GOODWELL
FINANCIAL STATEMENT, DECEMBER 31, 1916

This should be followed by the lists or schedules of Assets, Liabilities, and Net Worth as has been indicated. Since the statement is a formal one, due regard should be had for neatness and general appearance on the page. Further consideration of headings and titles will be taken up in Chapter XXX.

Principles Governing Fulness of Detail

Mention has been made of the importance of full information in the financial statement. The degree of fulness is

determined first by the general purpose which the statement is to serve; secondly, by the likelihood of obscuring essential data through too great detail; and thirdly, by the general appearance. If it can be shown on the statement that the business makes a careful valuation of its assets by taking into account the wear and tear on certain of its properties and the loss apt to occur through failure to collect all debts due the business, that statement points towards a policy of conservatism and efficiency not indicated by one failing to give that information. If a management has paid some of its expense bill in advance, e.g., rent for January paid during December, in showing financial condition as at the end of December it is right and proper and necessary, in order to make an accurate showing, that all such prepaid expenses be listed as assets; for had the prepayment not been made the cash would now be larger by the amount of the prepaid expenses. Similarly, if expenses have been incurred that properly belong to the present period but whose payment has been postponed to a later period, such as wages due but unpaid, those expenses should be listed among the liabilities, for the cash would be smaller by the amount of such postponed or accrued items had this claim been met during the current period. Hence, to take care of these prepaid and accrued items on the financial statement, we make a third group headed "Deferred Charges" for the assets, but usually show expense accruals under the head of Current Liabilities, listing under these heads by name the prepaid and accrued items.

Illustration

To illustrate the correct showing of the matters under discussion in this chapter, the following statement showing the financial condition of the partnership of Jackson & Edwards is given:

JACKSON & EDWARDS

FINANCIAL STATEMENT, JUNE 30, 1917

Assets

Current Assets:			
Cash		$2,365.00	
Accounts Receivable	$8,500.00		
Less—Reserve for Bad Debts	170.00	8,330.00	
Merchandise		10,425.00	
Supplies		80.00	
Deferred Charges:			
License Fees Paid in Advance		175.00	
Unexpired Insurance		75.00	
Fixed Assets:			
Furniture and Fixtures	$750.00		
Less—Reserve for Depreciation	75.00	675.00	
Buildings	$9,680.00		
Less—Reserve for Depreciation	242.00	9,438.00	
Land		2,500.00	
Total Assets			$34,063.00

Liabilities

Current Liabilities:		
Accounts Payable	$6,750.00	
Notes Payable	2,500.00	
Wages Accrued	250.00	
Interest Accrued	75.00	
Fixed Liabilities:		
Mortgage on Land and Buildings	2,500.00	
Total Liabilities		12,075.00
Net Worth		$21,988.00
Represented by:		
S. J. Jackson, Capital	$10,267.00	
P. R. Edwards, Capital	11,721.00	$21,988.00

To give the fullest information, an additional column to carry the totals of each group of assets and liabilities is frequently shown. This would make comparison of the groups somewhat easier and so make the statement more intelligible and valuable, although for a small business the information is easily obtained from the above showing.

One or two items, perhaps, need additional explanation. Reference has been made to the detailed information which the financial statement may give. In the one shown above it will be noticed that the proprietors, although having outstanding claims against customers for $8,500, recognize that, as their past experience has shown, they will be unable to collect all of these claims. Their estimate of the uncollectible portion is 2%, or $170, which is shown deducted from the face value of the asset in order to show a conservative realizable value. Similarly, it is estimated that furniture and fixtures, costing $750, have depreciated 10% in value and buildings 2½%. This statement, which shows the basis for valuing the assets, is more useful than one merely giving the net estimated values without showing how such values were obtained. The term "reserve" is used in the above in the sense of the estimated amount needed to make good the loss.

Problems

(Assignment for Chapter IV)

1. After operating for two years during which time their interests are kept equal Shongood and Goodwell realize that, if they are to meet competition on a satisfactory basis, they must secure large scale production. Therefore a company is formed with $75,000 capital stock, which takes over the partnership valuing its fixed assets at the figures shown in Problem 2, Chapter III, after allowing for depreciation at

the rate per year of 3% on buildings; 6¼% on machinery; 12% on office and 10% on shop furniture; 20% on models and patterns; 10% on delivery equipment. Small tools had been maintained at an even value for the two years. Assuming that no cash was turned over by the partnership and that all other assets and liabilities have the same values as shown in the previous problem, draw up a financial statement of the company, using the additional information that the balance of cash is $42,000 resulting from the sale of the stock and remaining after the purchase of the partnership assets mentioned above and of the good-will of the partnership for which $3,763 was paid.

2. The Blank Company is capitalized at $25,000. It has on December 31, 1916, outstanding obligations on open account of $5,621.75 and on its notes of $8,341.37. It owns property as follows: merchandise $5,339.40; cash $3,100.45; notes receivable $2,500; First National Bank stock $2,000; machinery and tools $10,000; furniture and fixtures $590; real estate $15,900; horse and wagon $500; accounts receivable $11,592.76. It is estimated that from the stated values machinery and tools have depreciated 12½%, furniture 10%, real estate 4% and horse and wagon 12½%, and that 2% of the outstanding accounts cannot be collected. Accrued pay-roll amounts to $500, and unpaid taxes $250. Interest earned but not due amounts to $175. Make a financial statement of the company.

Instructions

Refer to Chapter III for the manner of showing the net worth of a corporation.

In Problem 1, good-will is treated as an asset because actually bought and paid for. List it with the fixed assets.

CHAPTER V

COMPARATIVE FINANCIAL STATEMENTS

Comparison of Net Worths

The aim of every business enterprise is to increase its net worth. If James Runyon at the beginning of the year is worth $5,000, and if at its close his net worth is $7,500, it is evident that he has increased his wealth by $2,500. Very little information is given him or any one else as to the manner of the increase except that it came in the ordinary course of business transactions. No criterion is given by which we may judge effort by results. An increase of $2,500 may or may not be commensurate with the labors expended therefor. However, since it is very unlikely for any business to remain stationary, and since some method of determining that fact has been in use from the beginning of business endeavor, there is a degree of satisfaction in knowing merely how much that change is. The taking of an inventory and the appraising of one's properties from time to time and the setting over against them of one's liabilities for the same dates, give a basis for determining the increase or decrease, the gain or the loss for those periods for which records of net worth have been kept. A further analysis of the individual items, a comparison of each asset at the beginning of the period under review with its value at the end of that period, shows the increase or decrease in that item of wealth. In like manner a comparison of each liability item, at the beginning and end of a period, would bring out the increase or decrease in the amount.

How a Gain or Loss May Be Evidenced

During a period a gain or increase in net worth may be evidenced in any one of four ways. (1) If the assets remain the same but the liabilities are decreased; (2) if the liabilities remain the same but the assets are increased; (3) if assets decrease but liabilities suffer a greater decrease; or (4) if assets increase but liabilities suffer a lesser increase, provided no more money has been invested in the business, nor any been withdrawn, then there has been an increase in net worth, a profit. If the above relationships are reversed, then there has been a decrease in net worth, a loss.

The following statements illustrate the points discussed above:

AARON CONNERS

FINANCIAL STATEMENT, JUNE 30, 1916

Assets

Cash	$1,000.00	
Notes Receivable	250.00	
Accounts Receivable	5,250.00	
Merchandise	8,500.00	
Store Fixtures	525.00	
Total Assets		$15,525.00

Liabilities

Accounts Payable	$5,365.00	
Notes Payable	1,250.00	
Total Liabilities		6,615.00

Net Worth

Aaron Conners, Capital		$8,910.00

One year later Conners' financial condition is shown to be:

AARON CONNERS

FINANCIAL STATEMENT, JUNE 30, 1917

Assets

Cash	$850.00	
Notes Receivable	100.00	
Accounts Receivable	6,425.00	
Merchandise	10,260.00	
Store Fixtures	472.50	
Delivery Equipment	350.00	
Total Assets		$18,457.50

Liabilities

Accounts Payable	$6,192.75	
Notes Payable	950.00	
Accrued Salaries	50.50	
Total Liabilities		7,193.25

Net Worth

Aaron Conners, Capital	$11,264.25

The Comparative Financial Statement—Its Content and Method

The showing for the second year evidences an increase of net worth of $2,354.25, the difference between the net worths for the two periods. It shows also that this profit is accounted for by an increase of $2,932.50 in the assets of 1917 over those of 1916, but this is offset somewhat by an increase in the liabilities of $578.25, leaving a net increase of $2,354.25 as shown above. A comparison of individual items might be made, but the two statements as shown do not lend themselves easily to that purpose. Accordingly, a method of showing, known as the "Comparative Statement" form, is made use of—a form which brings all of the data into juxtaposition and so is easily read.

AARON CONNERS

COMPARATIVE FINANCIAL STATEMENT

June 30, 1917 and June 30, 1916

	1917		1916		Increases and Decreases	
Assets						
Cash	$850.00		$1,000.00		− $150.00	
Notes Receivable........	100.00		250.00		− 150.00	
Accounts Receivable....	6,425.00		5,250.00		+ 1,175.00	
Merchandise	10,260.00		8,500.00		+ 1,760.00	
Store Fixtures..........	472.50		525.00		− 52.50	
Delivery Equipment.....	350.00				+ 350.00	
Total Assets..................		$18,457.50		$15,525.00		+ $2,932.50
Liabilities						
Accounts Payable.......	$6,192.75		$5,365.00		+ $827.75	
Notes Payable..........	950.00		1,250.00		− 300.00	
Accrued Salaries........	50.50				+ 50.50	
Total Liabilities...............		7,193.25		6,615.00		+ 578.25
Net Worth						
Aaron Conners, Capital.........		$11,264.25		$8,910.00		+ $2,354.25

This form locates definitely the changes in the asset and liability items, summarizes those changes, and shows the net profit, but it fails to show what forces at work within the business organization brought about the changes shown; it shows effect or result but not cause. A supplementary, or rather a complementary, statement is needed for that purpose, and is discussed in the following two chapters.

PROBLEMS

(Assignment for Chapter V)

1. A. Howard at the beginning of 1916 had the following assets: real estate $2,500; furniture and fixtures $400; cash $1,550; accounts receivable $3,290; merchandise $5,710; and unexpired insurance for one year $50. His liabilities were: mortgage on real estate $500; accounts payable $3,000. At the end of 1916 he had assets and liabilities as follows: cash $1,000; accounts receivable $4,390; notes receivable $525; school district bonds $1,000; furniture and fixtures $360; real estate $2,425; merchandise $6,000; accrued expense items $125; notes payable $250; accounts payable $3,300. Determine Howard's profit or loss.

2. Make an analytical statement to show the effect on the business, i.e., the changes, of such profit or loss.

3. Can you tell how the change in proprietorship came about?

Instructions

Separate solutions for Problems 1 and 2 are not necessary. The comparative balance sheet set up for Problem 2 will serve also as a solution for Problem 1.

CHAPTER VI

THE ECONOMIC OR PROFIT AND LOSS ELEMENTS OF A BUSINESS

Fuller Information Needed

As was indicated in Chapter V, it is not usually sufficient to know merely that net worth has changed and how much the change has been, nor is the whole story told when it is known exactly wherein these changes have occurred, which of the properties are worth more and which less at the end of the period than at its beginning. Another kind of information is necessary to give a full knowledge of the conditions bringing about the changes shown by the comparative balance sheet.

The proprietor who knows simply that his cash is $1,000 less now than it was at the corresponding time last period, has not the kind of control over his business that his competitor has who knows that the $1,000 was expended for an increased stock of goods, or the one who knows that an outstanding liability of that amount has been settled, or the one who knows that his expenses for the period have been larger by $1,000 than for the former period. For, even this last competitor, though he may be worse off than the first proprietor, has at least this advantage—that he knows the reason for it. He has made a correct diagnosis, he knows the pulse beat of his business and is in a position to heal its ills or secure aid for them. If not, he can have the satisfaction of giving it a respectable burial and there will be no need for an autopsy. Simply, he failed to take advantage of his information until too late.

However, the point should be clearly held in mind that the proprietor who knows exactly what is happening in his business is in a position to exercise a definite and sure control over it. Hence, it should be the aim of the accounting department of every business, in order to justify its chief reason for existence, to give full information as to what is happening all the time within the business and what will be the result of such happenings in its financial life. Only in this way can the accounting department become one of the major departments of any business and so serve as a means of control.

The Two Kinds of Records

Accounting must therefore keep two kinds of records; not a double or duplicate record of every business dealing, but a record which looks at every transaction from two viewpoints, viz., what effect it may have on the assets and liabilities and what its effect may be upon the proprietorship. Only thus by recording the changes in proprietorship as they occur can a somewhat certain knowledge of the trend of affairs as to losses or gains, as to the sickness or health of the business, be indicated previous to the time of taking actual valuations of all assets and liabilities. These records of changes in proprietorship are sometimes kept in great detail, depending upon the degree of minuteness of the information needed or desired by a proprietor to give him adequate control. They comprise items or headings designed to indicate the sources of all earnings, such as sales, interest receipts, discounts received, rent income, and the like, and the causes of all outgo, such as clerk hire, office expenses, salaries, repair items, interest charges, and expenses of all kinds, grouped under separate heads, if such classes of information are vital to the conduct of the business.

Temporary Proprietorship Records

These proprietorship records or sources of information are kept until the close of the period, when they are summarized and the net result is determined. Hence, they are called temporary, being kept for the purpose of recording the changes in proprietorship as they occur from day to day, and then closed or transferred to the summarized record called the "Profit and Loss Summary."

Referring now to the case of Aaron Conners discussed in Chapter V, the accounting department furnishes the following additional information from its records:

During the year from July 1, 1916 to June 30, 1917, Conners bought $22,362.50 worth of goods; his sales amounted to $28,465.20; he paid for help $3,050.50; other expenses were $2,405.45; and he estimated the wear and tear on furniture at 10% or $52.50. As shown in his statement for 1917, he had $10,260 worth of merchandise on hand on June 30, 1917.

Analysis of this information develops an explanation of the changes which occurred in his net worth during the year. The goods he started with plus those purchased during the year give the total goods to be accounted for. This gives $30,862.50 ($8,500+$22,362.50=$30,862.50). These goods are accounted for by his having sold some and by having the rest on hand. Knowing how much is on hand June 30, 1917, viz., $10,260, he determines that the goods sold must have been the difference or $20,602.50 ($30,862.50 — $10,260 = $20,602.50). The price which he received for these goods sold was $28,465.20; hence, his profits from sales were $7,862.70, the difference between selling price and cost.

We find, also, that certain expenses were incurred in selling his goods and conducting his business. These expenses were $3,050.50 for clerk hire, office help, delivery

boys, etc.; and other expenses, such as rent, taxes, repairs, delivery up-keep, supplies, heat, light, and the like, amounted to \$2,405.45. He estimates that his store fixtures have depreciated in value \$52.50. All these items, representing costs of doing business, amount to \$5,508.45 (\$3,050.50 + \$2,405.45 + \$52.50 = \$5,508.45) which subtracted from his profits from sales, \$7,862.70, gives him a net gain of \$2,354.25 (\$7,862.70 — \$5,508.45 = \$2,354.25). This accounts for the increased proprietorship of that amount shown by the financial statement of June 30, 1917.

Without regard to a form which would be technically correct, the data of the preceding paragraphs may be shown as follows:

Goods on hand at the beginning, June 30, 1916		\$8,500.00
Goods bought during the year		22,362.50
Total goods to be accounted for		\$30,862.50
Goods accounted for, now on hand		10,260.00
Goods accounted for, by being sold		\$20,602.50
Selling price of goods sold		\$28,465.20
Cost price of goods sold, as above		20,602.50
Profit from sales		\$7,862.70
Expenses of doing business:		
Clerk hire	\$3,050.50	
Other expenses	2,405.45	
Depreciation	52.50	
Total expenses		5,508.45
Net profit, or increase in net worth		\$2,354.25

The technical form of the summary of the temporary proprietorship elements will be presented in the next chapter.

Problems

(Assignment for Chapter VI)

1. Referring to Problem 1, Chapter V, from the following data show the cause of Howard's changed proprietorship: depreciation on real estate $75; on furniture $40; interest paid on mortgage $35; rent and wages now due amounting to $125, as indicated; purchases for the year $19,790; sales $25,000; other expenses, including insurance, $3,200.

2. As proprietor of a business, you started the year with $20,000 worth of merchandise, you bought $100,000 more during the year, and have on hand at the end $25,000. If your gross profit on sales was $40,000, what was the amount of your sales? Selling expenses were $15,000 and general administrative expenses were $10,000. Make up a statement showing the profit for the year.

3. Alex. Tuttle, your branch representative at Duluth, reported to you his year's sales as $92,350, his purchases $75,790, gross profit of $12,630. Referring to previous records you find he had on hand at the beginning of the year $21,070 worth of goods and that the average cost of goods sold for the past five years has been 78.4% of the sales. What conclusion would you draw therefrom and what explanation would you ask Tuttle to make?

Instructions

In Problem 1 the information as to goods on hand at the beginning and at the close of the year must be secured from Howard's comparative balance sheet required by Problems 1 and 2, Chapter V.

CHAPTER VII

THE PROFIT AND LOSS SUMMARY

Titles for the Profit and Loss Summary

The profit and loss summary is known usually as the "Profit and Loss Statement," though other titles such as Loss and Gain, Income, Income and Expense, and Business Statement are frequently used. Showing as it does, the manner in which the net worth has been changed, it amplifies, it fills out the record shown by the financial statement. It is a supplementary record because it gives additional information, and is complementary to the financial statement because it rounds out and completes the story of business life there recorded.

The Fiscal Period

Because of the work involved and the frequent incompleteness of the records at the close of each day, a daily statement of condition is very seldom made up. Business experience for each particular enterprise determines the frequency of preparation of these statements. Whatever the period may be between statements, be it a month, three months, a half-year, or a year, it is called the fiscal period, i.e., it is the period at the end of which records are summarized and results obtained. For purposes of comparison with preceding and following fiscal periods, under similar conditions, the fiscal period should be, and usually is, a period of regular length, the half-year or year being perhaps the most common. In large enterprises and in many small enterprises monthly statements are customary.

Need for the Physical Inventory

Again, because of the work involved, especially where the product dealt in is small in value and sales are numerous, as in stores dealing in clothing, food, and the like, no record of the cost of each article is kept as it is sold, only the sale price being recorded. It is not possible, therefore, to determine from the records as usually kept, the cost of the goods on hand at a given time. The records are kept in this way not because systems of accounting cannot be devised to make both records, but because the results obtained by such systems are not justified by their cost, when other and less expensive means can be used with almost as satisfactory results. The customary method of finding the cost of goods sold was indicated in Chapter VI. Summarized briefly, it requires that, from the sum of goods on hand at the beginning and those purchased since, there be subtracted the goods on hand and unsold at the close of the period. This last item, the goods on hand and unsold, is secured by making an actual count and valuation of such goods at the close of the fiscal period. So the device of physical inventory-taking is brought in as an adjunct or aid to the accounting records, but this is done only in the interests of economy.

Principles Governing the Make-up of Profit and Loss Summary

The profit and loss statement, as the complement of the financial statement, is just as formal in character and the same general principles govern its make-up, viz., (1) the general purpose which it is to serve, (2) the likelihood of obscuring essential facts through too great detail, and (3) the general appearance as to legibility, clearness of form and expression, and arrangement on the page. Its heading is also similar to that of the financial statement:

SHONGOOD & GOODWELL
PROFIT AND LOSS STATEMENT,* DECEMBER 31, 1916

Content of the Statement

The information given first in this statement is the earnings or income from sales, the order of the showing being determined by the method of arriving at the net gain figure, viz., that of subtraction of expenses from income. Just as assets are normally larger than liabilities, so are income items larger than expenses, and they are therefore given first. Set over against the sales income is the cost of goods sold, resulting, by subtraction, in a showing of profit called "Gross Trading Profit." Next are given those expenses directly connected with the making of sales, such as store rent, clerks' or salesmen's salaries, advertising, delivery expenses, and the like. These portions of the statement comprise the "Trading" section because they are concerned only with sales and direct expenses of sales. The important groups or items shown in this section are Sales, Cost of Goods Sold, Gross Trading Profit, and Selling Expenses.

The next section or portion, called the "General Administrative," handles all other items of expense incurred in the management and general conduct of the business. The total of the two groups of Selling Expenses and General Administrative Expenses subtracted from the Gross Trading Profit gives the Net Profit for the period, unless there be other sources or items of income, which must then be added before obtaining the net profit for the period. Thus the profit and loss statement is very simple in its general make-up and method of showing, following the lines of reasoning of every merchant when summarizing his results for the period.

*"Statement of Profit and Loss" is an alternative form.

It should be noted that the above paragraphs outline a simple statement of profit and loss for a commercial or trading business as distinguished from an industrial or manufacturing enterprise, the statement for which is somewhat more complex even in its general outlines.

Algebraic Content of the Profit and Loss Statement

An algebraic presentation of the statement described above is oftentimes valuable. The cost-of-goods-sold portion becomes:

(1) Initial Inventory + Purchases — Final Inventory = Cost of Goods Sold

(2) Sales — Cost of Goods Sold = Gross Trading Profit

The rest of the statement is covered by the following equation:

(3) Gross Trading Profit — (Selling Expenses + General Administrative Expenses) + Other Income = Net Profit

The Disposition of the Net Profit

The net profit for the period belongs to the proprietor and constitutes an increase in his previous proprietorship or investment, unless he has already drawn out some of these profits as they accrued throughout the period. In this case, his drawings must be subtracted from the net profit indicated, before showing the increment to his net worth. Accordingly, the final section of the profit and loss statement gives the disposition of the net profit and its appropriation or addition to the previous net worth or proprietorship item. This section is known as the "Appropriation" section. If the business is a partnership, this section should show in detail the distribution of net profit among the several partners according to the agreement among

them as to the proportions in which they are to share gains or losses. If a corporation, it should give the disposition made of the net profit in the way of dividends to the stockholders, and any other appropriation made of these profits, including transfer to surplus.

To illustrate some of the features of the profit and loss statement, two illustrations are given, the first presenting a correct statement for Aaron Conners, using the data of Chapter VI, and the second showing a more complex statement.

Illustration 1

AARON CONNERS

PROFIT AND LOSS STATEMENT, JUNE 30, 1917

Sales for the year			$28,465.20
Goods on Hand June 30, 1916	$8,500.00		
Purchases during the year	22,362.50	$30,862.50	
Goods on Hand June 30, 1917		10,260.00	
Cost of Goods Sold			$20,602.50
Gross Trading Profit			$7,862.70
Clerk Hire		$3,050.50	
General Expenses	$2,405.45		
Depreciation	52.50	2,457.95	5,508.45
Net Profit for the year			$2,354.25

Illustration 2

JACKSON & EDWARDS

STATEMENT OF PROFIT AND LOSS, JUNE 30, 1917

Sales for the period	$42,560.25

Deduct:			
Goods on Hand June 30, 1916		$8,567.50	
Goods Purchased during year		35,293.75	
		$43,861.25	
Less—Goods on Hand June 30, 1917		10,425.00	
Cost of Goods Sold			33,436.25
Gross Profit on Sales*			$9,124.00
Selling Expenses:			
Salesmen's Salaries	$2,500.00		
Advertising	1,250.00		
Delivery Expenses	567.50	$4,317.50	
General Administrative Expenses:			
Supplies	$125.60		
Office Help	900.00		
Legal Advice	25.00		
Light and Heat	93.60		
Insurance	125.00		
Interest	32.50		
Miscellaneous Expenses	87.25		
Depreciation on Buildings	75.00		
Depreciation on Furniture and Fixtures	242.00	1,705.95	6,023.45
Net Profit for the year			$3,100.55
Appropriation of Net Profit:			
S. J. Jackson, 2/5 share		$1,240.22	
P. R. Edwards, 3/5 share		1,860.33	$3,100.55

NOTE: Frequently the totals of each expense section are labeled under their respective heads, as "Total Selling Expenses" and "Total General Administrative Expenses."

Additional Information Sometimes Given

It often happens that goods sold and goods bought do not prove satisfactory and are returned. When it is desired to give this information in the profit and loss state-

*This term is used sometimes instead of "Gross Trading Profit."

ment, the item "Sales for the Period," is extended short and the return sales deducted, only the "Net Sales" being full-extended. For example:

Sales for the period..........................	$50,000.00	
Less—Returned Sales........................	3,500.00	
Net Sales..		$46,500.00

Similarly, from the goods purchased during the year, extended short, the Returned Purchases are deducted and the "Net" extended.

If there is other income, such as Interest, Rent, Discount on Purchases, and the like, the title "Net Profit for the year" is omitted, only the amount showing. An additional group or section heading, "Other Income," is next inserted, followed by a detailed statement of the income items, just as in the other sections. The total of this section added, as indicated in equation (3) on page 46, gives the "Net Profit for the year."

It should be added, perhaps, that the above illustrative forms are not intended to be all-inclusive. At this stage, they are merely guides for the making of simple statements.

The Two Methods of Determining Net Profit

By reference to illustration 1, it should be noted that, of course, the profit shown by the profit and loss statement must be the same as that developed by the comparative financial statement, since both cover the same period and constitute merely two ways of developing the same result. For this reason they are valuable in proving the correctness of results, acting as checks against each other. The accounting department keeps both classes of records, viz., the asset and liability records and the temporary proprietorship records, not because both are needed to develop the amount

of net profit—either class would do this—but because both are needed for the additional information given by them.

Problems

(*Assignment for Chapter VII*)

1. During the year 1916, Edmunds and Hansen made sales amounting to $150,000, of which, however, $10,000 were returned as being unsatisfactory. Their purchases, including freight, were $89,000; the cost of goods sold was 60% of the net sales; and final inventory was $30,000. Expenses were: sales salaries $14,760; advertising $15,000; delivery expense $2,350; office salaries $5,000; rent $2,400; insurance $500; depreciation $1,000; office supplies $600; salaries of stenographers and bookkeepers $3,000; and general expense $2,150. Draw up a pro forma statement of profit and loss as on December 31, 1916.

2. Without any change in the other values shown in Problem 1, Chapter V, assume that the unexpired insurance there listed as $50 for the year is only for six months, at the end of which time a new two-year policy is purchased for $225. Assume further that by the end of 1916 interest has accrued on notes receivable amounting to $15; on notes payable $10; and on school bonds for nine months at 6%. Using the information given in Problem 1, Chapter V, and Problem 1, Chapter VI, and the additional data just given, determine, by the two methods referred to in the text, the amount of the net profit for the year.

Instructions

In Problem 1 "pro forma" means correct as to form. Study carefully the forms given in the text so as to become perfectly familiar with them.

In Problem 2, it should be noted that the changes from the data given before concerning Howard's business are not supposed to affect any of the values there shown. The effect will be, however, to add values for unexpired insurance and interest to the assets and liabilities. The change in the statement of profit and loss will be reflected in the interest items and in the item of "other expenses" which will be reduced by the amount of the unexpired insurance.

CHAPTER VIII

INTERRELATION BETWEEN THE ECONOMIC AND THE FINANCIAL ELEMENTS OF A BUSINESS

Various Aspects of the Temporary Proprietorship Records

The profit and loss statement has been explained as a summary of the temporary proprietorship records kept for the purpose of registering the changes in net worth as they occur from day to day, and also for the purpose of noting the source or cause of the changes in assets and liabilities. The temporary proprietorship records may be regarded as the chronicle or history of the economic life of a business. The efforts of the business to produce income with the least possible outgo in the form of costs or expenses may be viewed as the work of forces or agencies striving towards that end. Every effort is offset by the cost of that endeavor, and, unless the prime result of the effort be more than its cost, its aim, viz., the increase of net worth, is not accomplished.

Relation Between Profit and Loss and Financial Elements

These income-producing efforts are the agencies that bring about the changes in the values of assets and liabilities. All expenses and costs of the business are incurred for the purpose of securing the best possible results in the way of income. Every expense or cost that is settled causes a diminution of business assets, usually of the asset cash. If not settled, it causes an increase in the liabilities, usually the accounts payable, for the business becomes bound by or liable for it. Both of these conditions result in a decrease

in the net worth. On the other hand, every item of income is reflected by an increase in assets or a decrease in liabilities, as when a sale of goods is made. The result of every sale is usually an increase in the cash or in the claims against persons, the accounts receivable. It may sometimes result in a lessening of liabilities through the cancellation of income against others' claims on the business. So there is constantly this direct interrelation between the financial and the profit and loss elements of every business.

Exchanges Within the Asset and Liability Groups

All changes in individual assets and liabilities are not always, however, the result of business or economic forces. There may be an even exchange of one asset for another asset, as when we purchase a delivery equipment for cash. The asset, delivery equipment, is increased by the same amount as the asset, cash, is diminished. Or a bill of goods may be purchased on credit, and in this case an increase of assets is effected, exactly offset by an increase in liabilities. These changes are well illustrated by the second example in Chapter II, showing Runyon's proprietorship. Accordingly, therefore, the changes in individual assets and liabilities are not so certain an index of changes in proprietorship as those registered by the temporary proprietorship records. The vital history of a business is its profit and loss record, its economic life. As a means of control this is of first importance because it chronicles the causes of all changes in financial condition. The statement of financial condition may be looked upon as the framework, the skeleton of the business personality, upon which is superimposed its economic structure. When both the financial framework and the profit and loss summary are given, it is possible with reasonable accuracy to tell the whole history of the business activities for the period covered.

Illustration

By referring to the illustration of Aaron Conners given in Chapters V and VII, "Comparative Financial Statement" and "Profit and Loss Summary," respectively, it may be seen, with a fair regard for realities, just what took place in his business during the year. Giving summaries only, the story of his year's business reads somewhat as follows, numerous variations being probable, with net results remaining, however, the same:

He made sales of $28,465.20 to customers who paid in during the year $27,290.20. He purchased $22,362.50 worth of goods, making payments to creditors of $21,534.75. The net result of his notes receivable was the receipt of $150, and of his notes payable the payment of $300. He paid for clerk hire $3,000, still owing $50.50 at the end of the year; for general expenses he paid $2,405.45; and for a delivery equipment $350. He estimated depreciation on store fixtures at 10% or $52.50. His inventory showed merchandise on hand at the close of the year, amounting to $10,260.

An analysis of the cash shows the interworking of most of the transactions:

Cash Received

On Hand at start......		$1,000.00
From Customers	$27,290.20	
Notes Receivable	150.00	
Current Receipts.......		27,440.20
Total Cash............		$28,440.20
Disbursements		27,590.20
Balance on Hand at end		$850.00

Cash Paid Out

To Creditors..........	$21,534.75
Notes Payable.........	300.00
Clerk Hire............	3,000.00
General Expenses......	2,405.45
Delivery Equipment....	350.00
Current Disbursements	$27,590.20

An analysis of the accounts receivable shows:

Due from Customers at start of year.............	$5,250.00	
Sales to Customers during year..................	28,465.20	$33,715.20
Received Cash from Customers..........................		27,290.20
Balance Due from Customers at end of year...............		$6,425.00

An analysis of the other items will show similarly the interrelation between the economic and the financial elements of a business.

Problems

(*Assignment for Chapter VIII*)

1. On November 26, your stock of goods is destroyed by fire but your records are saved. They show that you started the year with $14,575.20 worth of goods, that you purchased during the year $73,974.75 worth, and your sales up to the time of the fire amounted to $97,534.69. Records for the past ten years showed an average gross profit on sales of 41.68%. What, approximately, was the value of the goods destroyed? Make a statement to show your claim.

2. From the following data concerning the Rawnser Goods Company, prepare pro forma financial and profit and loss statements: Goods on hand from previous year $12,000; purchases $70,000; sales $84,000; general expenses $2,000; salesmen's salaries $6,400; cash on hand $20; cash in bank $2,130; manager's salary $1,250; rent $900; freight-in $250; returned sales $750; returned purchases $400; business plant $11,000; accounts receivable $8,000; notes receivable $2,000; accounts payable $6,100; notes payable $850; interest received on deposits $100; office furniture cost $600; repairs to business plant $50; advertising $1,500; gain carried forward from last year $2,400; goods on hand now $14,600; advertising prepaid $50; office salaries now due but unpaid $200; rent unpaid $100. Allow 4% for depreciation on business plant; 10% on office furniture; and 5% for estimated bad debts. The capital stock is $25,000.

Instructions

Problem 1. It is quite customary, although not theoretically correct, to calculate percentages of profit, expenses, etc., on the basis of the net sales figure.

Problem 2. Carefully differentiate between the balance sheet and the profit and loss items. In the case of "prepaid advertising" an adjustment must be made, resulting in an advertising cost of $1,450 for the current period. Adjustments must be made for the unpaid items also. The profit for the current year added to that carried over from last year will give the figure for "surplus" to be used in the balance sheet.

CHAPTER IX

THE ACCOUNT

The Goal of Account Keeping

Throughout the preceding chapters constant reference has been made to records or data of the business furnished by the accounting department. Knowing the use made of those data in the compilation of financial and profit and loss summaries, knowing the goal, the purpose in the gathering of complete information about the business, we will trace the progress of that information, in exactly reverse order; first, through the ledger, where it is grouped and summarized and made ready for the preparation of statements; then into the books of first entry, where the information is sorted and classified with a view always to fit it ultimately into the final statements of financial and business condition; and finally, to the transaction itself which gives rise to the business papers, the basis or first source of all accounting records.

The Ledger Account Defined

We come first, then, to the ledger account. An account may be defined as a record of one or more items, either similar or dissimilar, relating to the same person or thing, kept under an appropriate heading or title. Accounts are kept both with persons, as the accounts receivable and payable already mentioned, and with things such as land, buildings, machinery, merchandise, cash, and the like. They are usually composed of both similar and dissimilar items; e.g., the cash account is composed of both cash received and cash paid out items; the accounts receivable record both the items for which the person is in debt to the business and those

which show the cancellation or settlement of the debt, in part or fully; and the accounts payable record the items for which the business is in debt to the person and those which show its cancellation or settlement by the business. Accounts may comprise only similar items, as where we record all sales of merchandise under one head or account and all purchases under another account.

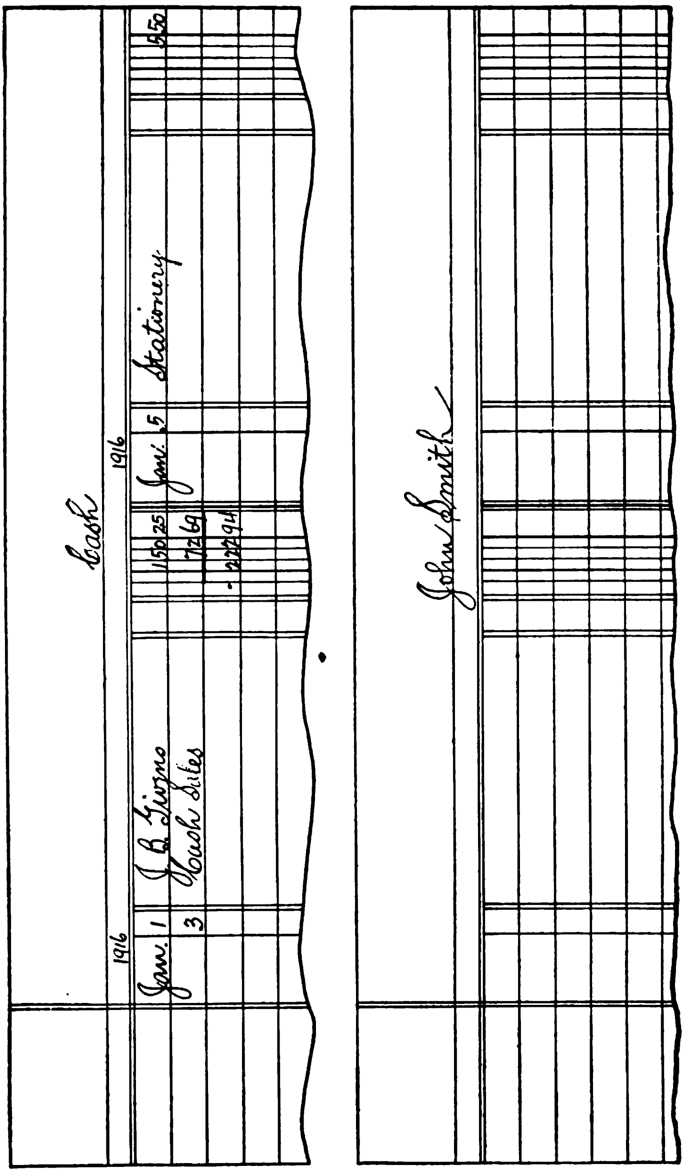
The Account Title

The title given the account is important. It should indicate clearly the content of the account. Exact truth is a basic principle in accounting. Correct titles are therefore essential. A title which does not clearly and truthfully indicate the nature of the account, or one which is chosen so that under it may be recorded items of various and doubtful kinds, gives prima facie evidence of an imperfect knowledge of accounting principles or of a desire to hide data which will not bear close scrutiny. Therefore, great care should be exercised in the selection of titles.

The Two Sections of the Account

To make a separation of similar from dissimilar items, the account is divided into two sections, a left and a right as we shall call them for the present, and is shown somewhat as in the standard form on page 58.

The account head or title is placed in the center over the division line. At the extreme left of each section are the date columns—year, month, and day. Note particularly where the "year" is shown. The next space is for explanatory matter; the next column, left blank in the illustration, is a reference column whose use will be explained later; and the last in each section is the money column, where the dollar subsection column is further divided into columns for each decimal of the amount, and care must be



Form of Ledger Accounts

exercised to observe such rulings when writing in the amounts. The account with Cash, in the illustration, shows on the left a receipt from J. B. Givens of $150.25, and, on the right, a payment for stationery of $5.50, items entirely dissimilar. Another receipt on January 3 from Cash Sales, of $72.69, is shown on the same side of the account as the previous receipt item and directly under it. Note that the name of the month is not repeated.

The Mechanism of the Account

Thus the mechanism of the account is designed not only for the purpose of giving a brief history of each item entered therein, but primarily in order to bring together all items of the same kind relating to that account, so that they may be summarized. It should be thoroughly understood that all items on each side of the account are similar items, though the two sides themselves are of exactly opposite kinds. Where the account has entries on both sides, i.e., is composed of dissimilar items, a comparison of the totals of each group shows the condition of the account. In the Cash account above, the total of the left side, $222.94, showing receipts, compared with the right, $5.50, showing disbursements, indicates that there is $217.44 cash now on hand. It is evident, therefore, that the account is a mathematical device by means of which all items to be added are placed on one side and all items to be subtracted are placed on the other side. Only in this way can the process of addition and subtraction be accomplished within the account.

The Ledger and Its Content

The book in which these accounts are kept is the ledger. It may be defined as the book of accounts. In it are collected most of the data needed for the final statements showing the financial condition of the business. By means of

its account titles, it makes an analytical record of all transactions, according to the information desired, and through the mechanism of the account it groups and summarizes all data affecting each particular account and so furnishes the proprietor with totals instead of items. In the ledger, therefore, must be kept two main classes of accounts, viz., those used for making up the financial statement, and those used for the profit and loss statement. The one group shows assets and liabilities, the other temporary proprietorship increases and decreases and ultimate or net proprietorship.

The Number of Accounts

The number of accounts to be kept in the ledger is determined by the minuteness of detail desired for the guidance of the management of a business. The financial and profit and loss statements usually lack detail and for this reason the items appearing there are frequently much subdivided in the ledger accounts.

Problems

(Assignment for Chapter IX)

1. Draw up from your own data a financial statement for a partnership. (At least 10 assets and 4 liabilities.)

2. Making your own assumptions, set up a financial statement for the succeeding year and a comparative statement for the two years. (Same as in Problem 1 above.)

Instructions

Refer to Chapter IV for the form of balance sheet for a partnership, and to Chapter V for the comparative balance sheet. Be careful to have a ratio of at least 2:1 between the current assets and current liabilities, and do not make much of a variation in the stocks of merchandise on hand for the two years.

CHAPTER X

THE ACCOUNT (Continued)

The Balance of the Account

It was stated in Chapter IX that the account is divided into two sections, a left and a right, for the purpose of separating items which are dissimilar but are related to the same account, and thus affording a comparison between the totals of these dissimilar groups. The account having in it dissimilar items, may have the same amounts in total, on each side, in which case it is said to balance, i.e., the one class of items exactly balances or cancels those of the opposite kind; or one side may be larger than the other, in which case the amount of the excess is called the balance in the account, or of the account, and takes its nature or classification from the larger side.

The Account Title Indicative of Its Classification

The account title or name should be so plain as easily to indicate its main classification. The two main classes of accounts are, as stated above, those relating to assets and liabilities, or property, things owned and things owed; and those relating to proprietorship, i.e., those showing the changes, increases or decreases, in net worth. If an account belongs to the asset or liability class, its title should clearly designate it as such. If it belongs to the proprietorship class, it should be clearly indicated.

The accounts called Cash, Accounts Receivable, Mortgages Payable, Accrued Wages, clearly show assets and liabilities; while those entitled Sales, Rent Income, Wages, Expenses, clearly indicate factors affecting proprietorship.

The Meaning of Account Balances

In the group of accounts indicating assets, the balance, or larger side, of the account is normally on the left, i.e., the balance of Cash, Land, Buildings, Furniture and Fixtures, Notes Receivable, and the like are normally left-side balances. It follows, therefore, that all entries showing the acquisition of such assets are made on the left side of their accounts and all entries showing the disposal of these assets are made on the right side of the accounts. Normally, the cancellations are never in excess of the assets listed on the left side, and therefore the balance is normally shown on the left side of asset accounts.

In the group of accounts indicating liabilities the balance is normally on the right, because liabilities are subtraction items from the assets and should therefore, normally, be on the opposite side of the account, i.e., Notes Payable, Accounts Payable, Mortgages Payable, Interest Payable, Rent Payable, and the like, have normally right-side balances. It follows, therefore, that all entries showing the assumption of liabilities are made to the right side of the account and all entries showing the cancellation of these liabilities are made on the left side. Normally, liability cancellations are never in excess of the liabilities owed; hence liability accounts show, normally, right side balances.

As will be explained in Chapter XI, in the group of accounts indicating decreases in proprietorship, the balance, or larger side, is normally on the left; in the group showing increases in proprietorship the balance is normally on the right. The balances of the accounts, Wages, Salaries, Rent Expense, and all other kinds of expenses, are normally left-side balances. It follows, therefore, that all entries showing the cost of such expenses to the business are made on the left side of the suitably named expense account, and all entries showing a reduction in the expenses set up are made

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on the right side; i.e., all items for wages are shown on the left, any subtractions from this Wages account because of overpayment or for other reasons, are shown on the right-hand side.

The balances of the accounts, Sales, Rent Income, Interest Income, and all other kinds of incomes, are normally right balances, from which it follows that all entries showing income are made on the right side of a suitable account, and all entries indicating a reduction or subtraction from the income shown are made on the left side of this same income account; i.e., all income from sales is shown on the right, while any reduction of that income, such as goods returned by customers as unsatisfactory, is shown on the left. Thus, knowing to what main class each account belongs—asset, liability, expense, or income—one always knows on which side normally the balance is and also that all items on the opposite side are subtraction items, and only in this way can subtraction be shown in the account. X

The Business Transaction Defined

Reference has constantly been made to business transactions. It may be well to show the idea at the bottom of every such transaction. We may define a transaction as an exchange of values. It may be between persons as when a sale is made, or it may be between accounts within the business itself, as when a transfer is made between accounts, i.e., an asset taken from one account and transferred to another for the sake of more clearly showing its nature. Some authors further analyze transactions as *completed* when the bargain is fully consummated between the parties, as when delivery is made and the money is paid in cash; or *incomplete*, as where something still remains to be done by either or both parties to the transaction. In this latter case, claims or rights of action arise to protect the parties until

full consummation is made. But, since from the accounting standpoint a claim or right is one kind of property or asset, there is little need of this finer analysis.

Analyzing the Transaction as to Its Accounting Record

As every transaction occurs in a business, it must first be classified before proper record can be made. Its elements must be analyzed, its effect on assets and liabilities or expenses and income must be determined. Has the transaction increased or decreased assets or liabilities, has it increased or decreased proprietorship, or has it resulted simply in a transfer between accounts—these are questions for first determination. The basis for all fundamental classifications is the proprietorship equation, or that equation expanded into the statements of financial condition and profit and loss. That is the goal towards which all records look, but the principle which determines the subdivisions in the main classes of accounts and gives title to the accounts to be carried in the records, is the amount and kind of information desired by the management throughout the fiscal period. After the transaction has been properly classified it is merely a matter of recording it according to the standards or forms of good accounting, i.e., the transaction is translated into correct accounting language, which is merely a device for abbreviation.

The Use of Debit and Credit

To show the side of the account affected by a transaction, the words debit and credit are used, indicating left and right respectively. The use of these words had its origin with transactions between persons and the accounts kept with them. The person owing was charged or debited while the person to whom the business owed a debt was credited. Through use the terms have come to have the

meaning stated first above, though still retaining their original connotation when applied to persons.

Fundamental Principle of Debit and Credit

Every transaction is recorded from two viewpoints, as stated in Chapter VI: as to its effect on the assets and liabilities and as to its effect on the proprietorship or net worth. Sometimes, however, the transactions may require merely a transfer entry, i.e., a transfer from one account to another without affecting the fundamental classes, as was indicated above when defining the transaction as an exchange of values. Remembering that, from long continued custom, asset accounts are debit accounts, i.e., normally have debit or left side balances, and liability accounts are credit accounts; that expense accounts are debit, and income accounts are credit, the fundamental principles for determining the debit and credit involved in every transaction are pretty well established. A detailed exposition of the principles of debit and credit will be deferred to the next chapter.

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PROBLEMS

(*Assignment for Chapter X*)

1. Draw up a profit and loss statement to account for the change in proprietorship shown by Problem 2 of Chapter IX, making your own assumptions as to items for the various sections of the statement.

2. State the probable business transactions occurring to bring about these changes in proprietorship—i.e., show the interaction of the profit and loss elements with the asset and liability elements in causing the changes in financial conditions.

Instructions

In Problem 1 make your assumptions reasonable. As a guide, assume a rate of turnover of anywhere from 2 to 6. By rate of turn-

over is meant the number of times the initial inventory is contained into the cost of goods sold. Under ordinary conditions the final inventory does not vary much from the initial. Assume a gross profit of from 25% to 40%. These assumptions will fix the amounts for sales and purchases. Allow, say, 15% to 25% for selling expenses and 5% to 10% for general administrative expenses. All these percentages are to be based on the sales figure.

CHAPTER XI

THE PHILOSOPHY OF DEBIT AND CREDIT

Attempts to Reduce Debit and Credit to One Rule

Elaborate efforts have been made to reduce to one basic rule the theory of "debit" and "credit" as applied to every transaction that may arise. The invention of the ideas of account personification, account responsibility and accountability, has had its mothering in the need felt for a rule-of-thumb method by whose magic all transactions might be reduced to correct accounting terminology. The value of these ideas is unquestionable and no thought to gainsay them or discredit them is in mind. Suffice it to say, that such theories require for their proper application a depth of reasoning and a knowledge of the subject not to be expected of beginners, and an elasticity of mental fibre and imaginative functioning not always met with in the adept.

It should be stated that no attempt is made herein to present a new theory of debit and credit, the only claim advanced being in the method of presentation and the previous preparation of the learner's mind for its reception. It is believed that familiarity with the end and aim of all accounting, the basic problem of accounting—and in its simpler forms, such problem is within the grasp of anyone—will provide fit and adequate preparation for intelligent use of the tools and devices of accounting.

Origin of the Use of Debit and Credit

There can be no question that the use of "debit" and "credit" had its beginning with personal accounts. Acci-

dent and general acceptance through continued use made the left side the debit and the right the credit. The extension of the application of the terms to all other classes of assets and liabilities and to the temporary proprietorship data in the system of double entry, was undoubtedly the gradual outgrowth of the proprietorship equation used throughout this work, requiring that proprietorship be placed on the credit side in order to secure balance or equality of debits and credits and, thus, proof of mathematical correctness.

Basis of Debit and Credit as Used Here

Reverting, then, to the ideas of the financial and profit and loss statements and to the account as a device for sorting and assembling the data used, with its method of indicating the processes of addition and subtraction of similar and dissimilar items—things which we may term accounting axioms—it is believed that the determination of the debit and credit elements of the business transaction is within the ken of a beginner. It was stated that accounts with property owned—assets—are normally debit balance accounts; those with property owed—liabilities—are normally credit balance accounts; that temporary proprietorship accounts, making record of the agencies or forces within the business, are normally debit balance accounts if they tend to decrease proprietorship, and credit balance accounts if they tend to increase proprietorship, because through the necessary placing of proprietorship on the credit side of the account, debit entries subtract from it and credit entries add to it.

Starting, therefore, with the original investment, whatever form it may have, the transaction is reducible to the fundamental equation:

$$\text{Assets} = \text{Liabilities} + \text{Proprietorship}$$

in which "liabilities" may or may not be a "zero" quantity, depending on the nature of the investment. All transactions thereafter must be viewed according to their effects on the three terms of the equation above. We may summarize the effects produced by the various transactions of business as:

Increase or decrease of assets
" " " " liabilities
" " " " proprietorship

with this qualification—that some transactions result in transfers only without affecting the totals of any of the three groups above.

The Debit and Credit Schedule

Bearing in mind the customary distinction between debit and credit, and the fact that entry of a transaction is always made from a double viewpoint—that of cause and effect—every transaction may have its debit and credit determined by the following schedule:

Debit:	*Credit:*
(1) Increase of Assets	(a) Decrease of Assets
(2) Decrease of Liabilities	(b) Increase of Liabilities
(3) Decrease of Proprietorship	(c) Increase of Proprietorship

Debit and Credit Determination Illustrated

Examples illustrating the various classes of transactions and the determination of their debit and credit will now be given. The student should strive to understand the double point of view necessary in debit and credit determination. It is perhaps well to call attention to the fact that the following illustrations are entirely unrelated, i.e., do not apply to a sequence of events in any business. It should also be

kept in mind that transactions are recorded always from the standpoint of the business whose records are being kept.

1. The purchase of merchandise for cash.

The result is an increase of the asset Merchandise caused by the decrease of the asset Cash. Accordingly, the debit and credit of the entry for the transaction are shown by the above schedule under (1) and (a), i.e., debit Merchandise and credit Cash. This is also an illustration of the transfer entry referred to above in which there is no increase or decrease of total assets, liabilities, or proprietorship.

2. The purchase of merchandise on account.

This results in an increase of assets caused by the increase of liabilities. The schedule above shows under (1) and (b) a debit to Merchandise and a credit to the personal account payable, indicated by the name of the creditor.

3. The receipt of cash for services performed, as when a broker receives the amount of his commission in cash.

The result here is an increase of the asset Cash, caused by the increase of proprietorship, for the performance of services is the chief source of the broker's income. The schedule shows under (1) and (c) a debit to Cash and a credit to some temporary proprietorship account by name, as Commission Earned.

4. The payment of a note payable in cash.

This results in a decrease of the liability, Notes Payable, caused by the decrease of the asset Cash. Accordingly, debit Notes Payable and credit Cash, (2) and (a).

5. The settlement of a personal account payable by giving a note payable.

The effect here is simply a cancellation of one kind of liability for another kind, a transfer entry. Debit the personal account payable; credit Notes Payable, (2) and (b).

6. The rendering of a business service to a creditor, thereby cancelling an indebtedness to him; as when a physician renders medical aid to his creditor from whom he has purchased supplies.

The effect is a decrease in liabilities and an increase in proprietorship. Debit the personal account payable, by name, and credit some temporary proprietorship account, by name, as Fees or Services, (2) and (c).

7. A workman is paid his wages in cash.

The result is a decrease in proprietorship and a decrease in the asset, Cash. Wages are a cost of doing business and therefore decrease proprietorship. They are a service rendered to the business instead of by it, an expense as distinguished from an income. Debit the temporary proprietorship account, Wages, and credit Cash, (3) and (a).

8. We credit the account of a lawyer for the amount of his fee.

A decrease of proprietorship, for the service rendered us, and an increase in liabilities. Debit Legal Expense and credit the personal account payable, (3) and (b).

9. Transfer the net gain shown by the Profit and Loss account to the Surplus account.

The result is a simple transfer, causing a decrease in proprietorship as shown in the Profit and Loss account and an increase in proprietorship as shown in the Surplus account. Debit Profit and Loss and credit Surplus, (3) and (c).

In a similar manner, all transactions may be analyzed and their entry in the accounts determined.

Necessary Equilibrium of Debits and Credits

Before passing on to more detailed rules for debit and credit, careful attention is called to the constant equality of

debits and credits. Starting with the proprietorship equation expressed in this form—

Assets = Liabilities + Proprietorship

of which the left side is represented in the accounts by debits and the right side by credits, the equality of the debit balances and the credit balances of the accounts in the ledger is readily seen. If, now, for all succeeding transactions an entry is made having an equal debit and credit, evidently the equilibrium of the total debits and credits in the accounts is maintained. The making of an equal debit and credit for every entry is fundamental and must be strictly observed.

Problem

(Assignment for Chapter XI)

1. Using the schedule shown on page 69, write out at least three examples of each class and show their effects in each of the three opposite classes. (27 examples.)

Instructions

Name the debit and credit elements of each example.

CHAPTER XII

DEBIT AND CREDIT AS APPLIED TO ASSET AND LIABILITY ACCOUNTS

Student's Use of Working Rules

For the guidance of those who find it difficult to apply the schedule shown in Chapter XI, somewhat detailed working rules will now be given for determining the debit and credit in the main groups of accounts, supplemented by a reference guide by which to check the accuracy of the work. Only such entries as are more frequently met with will be discussed. Since, in the group accounts given as guides, only those entries appear which affect those groups, it is deemed impracticable to attempt to show the contra, or other side of each entry. However, the student should always supply mentally the contra of each entry shown in the group reference account.

Accounts with persons will be shown first, those with customers followed by those with creditors. Of course, each account bears the name of the person whose transactions are recorded therein.

Accounts Receivable

(Name of Customer)

Debit:	*Credit:*
(1) For amount owing us at beginning.	(a) For money paid us on account.
(2) For goods sold them on account.	(b) For notes given us on account.
	(c) For goods they return to us.
	(d) For discounts given them.
	(e) For claims allowed them.

The balance owing us by a customer is an asset, and therefore a debit item.

Goods sold on account are charged to the customer because our claim against him constitutes an asset; at the same time some income account, as Sales, is credited.

When a customer pays us on account, his account is credited and Cash is debited, showing an increase of the asset Cash and a decrease of the asset Accounts Receivable. It is simply a transfer entry, an increase of one asset offset by a decrease of another asset.

When a customer gives us his note, his account is credited and Notes Receivable is debited, usually, with the face of the note.

When a customer returns goods to us, he is credited to decrease the original charge to his account and Sales or Returned Sales is debited to reduce the income originally credited to Sales. It is not necessary to make any other record of the returned goods, because, as was explained in Chapter VII, no day-to-day record is kept to show the decrease of the asset Merchandise through Sales. So, when goods are returned by a customer, the increase of the asset Merchandise will be shown at the end of the fiscal period when the merchandise inventory is taken, and no other record than that indicated is necessary.

When a customer is allowed a discount for the early payment of his bill, he is credited to reduce the original charge by the amount of the discount, and some temporary proprietorship account, as Discount on Sales, is debited to show decrease in proprietorship resulting from the allowance of the discount.

When a customer is allowed a claim for reduction in his bill on account of damaged goods or the like, the entry is similar to the one next above. Debit Claims and Allowances and credit the customer.

Accounts Payable

(Name of Creditor)

Debit:	*Credit:*
(1) For money paid them on account.	(a) For amount owing them at beginning.
(2) For notes given them on account.	(b) For goods sold us on account.
(3) For goods we return to them.	
(4) For discounts given us.	
(5) For claims allowed us.	

As will be noted by reference to the customer's account in the preceding section, the entries to the creditor's account are exactly similar to, but being viewed from an opposite standpoint, are the reverse of, the entries to the customer's account.

Accounts with Media of Exchange

Accounts with media of exchange are those with cash, notes receivable, and notes payable. Entries to them are comparatively simple and are shown in the following schedule:

(Name of Account)

Debit:	*Credit:*
(1) For all receipts or incoming items.	(a) For all disbursements or outgoing items.

Transactions with Cash are self-explanatory.

The accounts representing transactions with notes require some explanation. When, in the course of business, another's note is received by us, Notes Receivable is debited and the person from whom we receive it is credited, because our asset Notes Receivable is increased and the

claim against the open account of the person giving us the note is decreased. Similarly, when that note is disbursed by us, i.e., goes out of our possession, the asset is diminished and therefore Notes Receivable credited.

A note receivable can be disposed of in several different ways: (1) through its release on payment by the maker, (2) through its transfer by us to another person in settlement of a claim against us, or (3) through its sale to the bank. In all of these cases the credit goes to Notes Receivable. In cases (1) and (3), the asset increased, viz., Cash, is debited; and in case (2) the liability cancelled or decreased is debited. It may be stated, however, that in cases (2) and (3), instead of making the credit direct to the asset account Notes Receivable, it is better carried to a supplementary account, Notes Receivable Discounted, in order to show the liability arising from the fact that, through our indorsement, we guarantee to pay the note at its maturity in case the maker fails to do so. This matter is explained in detail later.

When we issue our own note, the credit is to Notes Payable and the debit, either to the liability account reduced or to the asset account increased. When we call that note in, receiving it back through payment by us or through cancellation of our claim against the person returning the note to us, Notes Payable is debited and Cash or the person returning the note is credited.

Other Liability Accounts

Accounts with other liabilities such as Mortgages, Bonds, Expenses Payable, and the like, in the main, follow the general principles laid down. Specific treatment will be given as these are met. In the case of long-time notes payable supported by mortgages, record should be made under the title "Mortgages Payable" rather than "Notes Payable."

Accounts with Fixed Assets

Accounts with fixed assets are those with land, buildings, and equipment of all sorts.

(Name of Account)

Debit:	*Credit:*
(1) For full cost to the business in position ready for use.	(a) For sale or loss, at cost price.

The debit is not for invoice or first cost only, but includes all expenditures necessary to secure full title or to place the equipment in position for use by the business, such as abstract of title costs, freight, drayage, and, in the case of machinery, setting-up and placement costs. The corresponding credit is usually to Cash, or Notes or Accounts Payable.

The account is credited for the sale of all or a portion of the asset at the same price at which it was originally charged, so that the balance in the account shows the cost of the part left. A loss from fire or otherwise is treated similarly. When the asset is sold at a profit, the excess over the cost price is credited to a proprietorship account such as Profit on Sale of Machinery. The debit corresponding to these two credits is usually to Cash or other asset received in payment for the asset sold. Where the asset is sold at a loss, the deficiency is debited to a proprietorship account, such as Loss on Sale of Machinery, and the additional debit is to Cash or some other asset received; this debit amount plus the debit to Loss on Sale of Machinery being, of course, equal to the credit item representing the cost of the asset sold.

Further consideration of fixed asset accounts is given in Chapter XIV, where loss through depreciation is shown.

Problems

(*Assignment for Chapter XII*)

1. On August 1, 1917, A. B. Carnahan, a customer, owed us $135.30; August 3, he paid $75 on account; August 10, he purchased goods amounting to $45.20; August 12, he returned $10 worth of goods as unsatisfactory; August 20, he paid $31.68 in full settlement of his purchase of the 10th, being allowed a 10% discount for prompt payment; August 25, he purchased a bill of goods amounting to $87.50. Set up Carnahan's account as it would appear in our ledger.

2. On March 5, 1917, we gave our note in settlement of account with D. E. Faraday & Co., the balance to date being $375; March 10, we purchased goods to the amount of $750; March 15, we returned $50 worth of goods as not being what was ordered and put in a claim for $25 on account of some goods not being of first class quality; March 24, we paid $300 on account; and on March 29, we purchased goods for $550. Set up Faraday & Co.'s account as it would appear in our ledger.

3. (a) Using the data of Problem 1, set up our account in Carnahan's ledger.

(b) Using the data of Problem 2, set up our account in Faraday & Co.'s ledger.

4. Set up a Cash account for the following: received cash June 25, 1917 from a note discounted at the bank $990; June 28, paid out $25 for stamps, $125 for delivery wagon, $250 for a horse, and $50 for harness; July 2, received from sales $500; from customers on account $785.50; July 3, paid creditors $1,000; clerks $250; rent $300.

5. Set up a notes receivable account for the following: April 2, received A. B. Clay's note for $500; April 10, received note from J. B. Gaynes for $250; April 12, transferred Clay's note in settlement of our account with Jacks & Co.; April 15, received R. B. Dobbs' note for $375; April 21, discounted Dobbs' note at the bank; April 30, received payment of Gaynes' note.

6. We purchased August 25, 1917, machinery for $1,500, f. o. b. factory; the freight and drayage amounted to $150; the cost of installation and attachments was $250. After using same for six months, one machine costing complete $225 was sold for $200. Show the above items in the machinery account.

7. A piece of real estate was bought April 4, 1917, for $50,000. Investigation of title costs amounted to $1,000; side walks, curbing, and street paving amounted to $585.50. The land was sold one year later for $75,000. Set up the land account covering the above.

Instructions

In all of the above accounts have particular regard to the technique of the work—correct dating, correct entry of the amounts, etc. Follow the forms illustrated in the text. There is not required in the above solutions the setting up of the contra side of each entry. Each transaction should, however, be completely analyzed as to its debit and credit elements, although only the one is to be set up.

CHAPTER XIII

DEBIT AND CREDIT AS APPLIED TO PROPRIETORSHIP ACCOUNTS

Proprietorship Accounts Defined

Proprietorship accounts are the accounts which record the effects, both temporary and ultimate, of business transactions upon proprietorship. Not all transactions affect proprietorship. The schedule in Chapter XI shows that none of the interrelations among (1), (2), (a), and (b) increase or decrease proprietorship; nor does a transaction involving only (3) and (c). It is only when we have a combination of (1) or (2) with (c), or a combination of (a) or (b) with (3), that proprietorship is affected. Proprietorship accounts are of two general kinds, temporary and vested. Temporary proprietorship accounts make temporary and immediate record of the results of the agencies or forces at work within the business to produce a profit. They set forth the efforts of the business to produce an increase in net worth. They record the costs of the effort and its yield in earnings, the record being made under appropriate titles to show the kind of cost and the source of the yield. Vested proprietorship accounts make record of the ultimate or summarized results of business transactions. They therefore record the original investment with its subsequent increases and decreases.

Customary Explanations of Debit and Credit of Temporary Proprietorship Accounts

Before discussing the rules for the determination of the debit and credit of proprietorship accounts, it may be well

to refer again to the attempt made to reduce the determination of all debits and credits to one fundamental rule. A statement of the attempt and the difficulties attending it was made in Chapter XI. Those difficulties increase greatly when the explanation of expenses and income is met with. To bring their debit and credit determination under the basic rule, it becomes necessary to find a similarity between expense and asset items, for both are debits, and between income and liability items, for both are credits. This has led to some plausible explanations of the relationship between them—and other explanations not so apparent. It may be easy, even for the beginner, to see that the application of expenses upon certain assets results in an asset of greater value, by the amount at least, of the expenses applied thereto, as when labor, supervision, power, etc., are applied to the asset, raw lumber, there may result a piece of furniture, an asset, whose value includes the value of the original asset and that of the expenses incurred in changing it to its present form. It is not so apparent, however, that store rent, salesmen's and stenographers' salaries, advertising, telephone charges, and the innumerable other costs that every business has to meet, are applied to the assets and become an integral part of them.

This attempt to reduce debit and credit to fundamental simplicity also sets up a relationship between liabilities and income. It explains the relationship by looking upon the business as an entity distinct from its owners, and therefore liable, or at least accountable, to them for its earnings. While these relationships between expenses and assets and income and liabilities may be said to exist, it is believed more logical, and easier for the beginner, to hold to the tripartite classification used from the beginning as seen in the proprietorship equation, viz., assets, liabilities, and proprietorship. The explanation of the *account* as a device for

grouping similar items on one side and for securing deductions from them by entry on the opposite side, and the use of the fundamental classification above, are believed to give the best explanation of the determination of debit and credit for all kinds of entries.

Fundamental Consideration of Proprietorship Debits and Credits

Accordingly, expenses and income are not shown in an asset and liability relationship, but are classed with proprietorship as *temporary* proprietorship items which after being summarized will show their ultimate effect upon *vested* proprietorship. In other words, they are proprietorship items set up temporarily to furnish detailed information for aiding in efficient management and control after which they will be transferred to the ultimate or vested proprietorship records. Since, from the mathematical necessity of the proprietorship equation, proprietorship items have normally credit balances, it is evident that all income, all earnings, must be placed on the credit side of their appropriate accounts, because, at least temporarily, they increase proprietorship. Similarly, all expenses, because they take from or reduce proprietorship, must be recorded on the debit side of their appropriately named accounts.

Income Debits and Credits

With regard to their debit and credit, income accounts follow this rule:

INCOME (Under appropriate titles)

Debit:	*Credit:*
(1) For all deductions from the yield shown contra.	(a) For the yield.

Income accounts normally have entries only on the credit side. They will be debited, however, for the purpose of deducting from the yield shown on the credit side, (1) because of overstating the amount of yield in the first place; (2) because of error in the original placing of the item of income, now necessitating its transfer to some other account; and (3) for the purpose of summarizing, when it becomes necessary to transfer all income and expense items to one summary account. These debit entries are sometimes called adjusting and closing entries.

Expense Debits and Credits

With regard to their debit and credit, expense accounts follow this rule:

EXPENSE (Under appropriate titles)

Debit:	*Credit:*
(1) For the cost.	(a) For all deductions from the cost shown contra.

Expense accounts normally have entries only on the debit side. Their credits are for purposes similar to the debits to income accounts as stated just above.

Examples of temporary proprietorship items can be found in Chapters VI, VII, and VIII, where the profit and loss summary is treated.

Vested Proprietorship Debits and Credits

Two accounts should be kept on the ledger with the proprietor, a capital and a personal account, i.e., "John Doe, Capital" and "John Doe, Personal." The Capital account shows the original investment or the amount of capital now in the business as shown by the last financial statement. The Personal account shows all direct changes

made in the capital during the fiscal period either through withdrawal or through additional investment of funds or properties. The Capital account, therefore, shows no change until the close of the fiscal period, when the increase or decrease in net worth is transferred to it. An exception to this is sometimes made when there is evident intention to withdraw during the period some of the invested capital, in which case such withdrawal is shown in the Capital account as a debit or subtraction item. Also, if there is evident intention to increase the investment during the fiscal period, record of it is sometimes made in the Capital account. Practice in this regard is not uniform.

The ordinary transactions with the proprietor, such as withdrawals of more or less regular amounts in cash or goods and other similar transactions, are recorded in his Personal account. This is his current account as distinguished from his more permanent Capital account. Both of these accounts may be termed vested proprietorship accounts. Their debit and credit schedule appears as follows:

(Name of Account)

Debit:	*Credit:*
(1) For amounts or values withdrawn.	(a) For amounts or values invested.

The Capital account usually shows only one item throughout the period until its close; the Personal account shows both debits and credits, according to the above schedule. The Personal account ordinarily shows transactions of the following kind: on the debit side, withdrawals in funds or goods; the payment or assumption by the business of the personal debts of the proprietor; his retention of any funds or properties belonging to the business, such as collections from customers; on the credit side, the in-

vestment in the business of any funds or properties; the retention by the business of any funds or properties belonging to the proprietor, as where the business collects and retains a debt due him personally; and the payment or the assumption by him personally of any debts of the business.

PROBLEMS

(Assignment for Chapter XIII)

1. Set up the accounts, both debit and credit, for the following transactions. List all expense items under a general title, Selling Expense. Be careful to maintain the debit and credit equilibrium. Paid in cash on the dates given: March 1, 1917, salesmen's salaries \$475; March 7, delivery expense \$75; March 9, boxes for shipping \$15; March 10, premiums \$42.65; March 10, salesmen's commissions \$50; March 11, salesmen's traveling expenses \$230.45; March 12, advertising \$125; March 15, out-freight \$15.32; March 15, insurance on stock \$22.50; March 18, packing supplies, paper, etc., \$73.40; March 23, shipping clerks' wages \$50; March 30, sales show room rental \$75. March 7, cash was received as a premium on exhibit at fair \$25; and from the sale of a small parcel of packing supplies \$2.50.

2. Set up the debit and credit of the following transactions under suitable account titles: paid in cash, December 1, 1916, general manager's traveling expense \$25; December 3, stamps \$5; December 5, telegrams \$11.50; December 10, burglar insurance on safe \$15; stationery \$25; December 12, rubber bands \$1; December 15, stenographers \$50, office boy \$12; December 20, clips, fasteners, pins \$1.50; December 24, Christmas gifts to employees \$100; December 26, general manager's entertainment expense \$15; December 27, R. G. Dun, credit rating service \$12.50; December 31, telephone \$10.50, rent of office \$175, bookkeepers \$150, stenographers' supplies, ink, etc., \$10; stenographers \$50; office boy \$15; general manager's salary \$250; lighting \$2.50. Received checks, December 31, for rent of desk room in office \$25, and telephone service \$2.50.

3. Enter the following data in one General Expense account: paid rent \$75; office supplies \$15; repairs on delivery auto \$20: tele-

grams $2.05; insurance $50; office help $40; printing and advertising $60; electric sign $25; discount on money borrowed at bank $3; received interest on loan $5.60; paid window-lettering $3; coal $28; telephone $3.05; traveling expenses of salesman $75, and of manager $10; salesman's salary $150; gasoline for auto $15; wrapping paper and twine $10; postage $12; bags and cartons $7.50; street car tickets $5; and typewriter repairs $2.50.

4. From the data in Problem 3, prepare accounts with: Delivery Expense; Advertising; General Selling Expense; Office Supplies; General Office Expense; Interest and Discount.

5. Proprietor invests $10,000; he withdraws $2,000; pays a business debt of $500 out of his private funds; he turns into the business a piece of real estate valued at $5,000; he pays his personal note out of business funds $500; his personal account credit balance of $1,500 is transferred to his capital account. Prepare proprietor's capital account, treating all of the above items therein.

6. Proprietor paid personal coal bill $30 from funds of business; withdrew cash salary $25; collected miscellaneous small acounts $22.40 and retained money for private use; paid house milk bill in trade $6.20; had his account credited with two weeks' salary $50. Prepare proprietor's personal account.

Instructions

Problem 1. Where the items are small and of infrequent occurrence, credits to expense accounts are sometimes made rather than to separate income accounts opened specially for these items.

Problem 2. Suggested account titles for these data are Manager's Expense, Office Supplies, Telegrams and Telephone, Sundry Office Expense, Office Salaries, and Rent. Other subdivisions may be made, according to the information desired.

Problems 3 and 4 are given to show, first, how a General Expense account is sometimes—wrongly—used as a "dump" for all sorts of things and, secondly, how it may be analyzed to secure desirable information.

CHAPTER XIV

DEBIT AND CREDIT AS APPLIED TO MIXED ACCOUNTS

Analysis of a Sale Transaction

The impracticability of immediate separation of each sale of goods into its two elements of cost and profit and the use of the physical inventory as a device for separating these two elements were discussed in Chapter VII. The following is an analysis of a sale transaction. Suppose an article costing $10 is sold for $12. At the time of the purchase of that article a debit was made to Merchandise account and a credit, say, to Cash. When the article is sold, it would seem that the credit should be to Merchandise to show the decrease in that asset. However, in the sale price of $12 is included something more than the amount by which our stock of merchandise is decreased, viz., a profit of $2. Hence, a credit to Merchandise of $12 would result in too large a subtraction from the asset Merchandise, if it is intended that the Merchandise account shall always show by its balance the value of the unsold stock. Theoretically the best method of entering this sale would be to debit Cash for $12, and to credit Merchandise with $10 and Profit with $2.

The Old Merchandise Account, Its Content and Significance

It is impracticable, however, to compute and record the cost of every unit sold. Using the above illustration, instead of crediting Merchandise with $10 and Profit with $2, we place the entire $12 to the credit of the Merchandise account, but by doing this the Merchandise account no

longer represents the one asset Merchandise, but is a mixture of an asset and a proprietorship account, and these two elements must be separated at the close of the period. Originally, the merchandise account was kept in this way; it was a *mixed* account and followed the rules of debit and credit as shown below, the amounts being given for purposes of illustration:

A MERCHANDISE

Debit:		Credit:	
(1) For goods on hand at beginning	$10,000.00	(a) For sales	$25,000.00
(2) For purchases, sometimes including freight-in, drayage-in, etc.	20,000.00	(b) For returned purchases	2,000.00
(3) For returned sales	1,000.00	(c) For purchases rebates and allowances	100.00
(4) For sales rebates and allowances	500.00		

Where the account is kept in this manner it is usually burdened with the additional data listed under (3), (4), (b), and (c). Sales being a credit item, it is plain that subtractions from sales (3) and (4), must appear on the debit side, and, purchases being a debit item, subtractions from purchases (b) and (c) must appear on the credit side. If these subtractions were actually performed instead of being indicated in the account, the debit side would show net goods to be accounted for, viz., goods on hand at the beginning, $10,000, plus *net* purchases, $17,900, making a total of $27,900; and the credit side would show *net* sales, $25,000 minus $1,500, or $23,500. If, now, the cost value of the goods on hand at the close of the period (as deter-

mined by physical inventory) equals $8,000, it is evident that the cost price of the goods sold is equal to the cost value of the goods to be accounted for, minus the cost value of the goods left on hand, or $27,900 minus $8,000 equals $19,900. To secure this subtraction ~~within the account, it~~ is necessary to enter on the credit side this $8,000, the cost value of the final inventory. Accordingly, an additional credit item (d) is inserted, after which the account will show:

B MERCHANDISE

Debit:		*Credit:*	
(1) For goods on hand at beginning	$10,000.00	(a) For sales	$25,000.00
(2) For purchases, sometimes including freight-in, drayage-in, etc.	20,000.00	(b) For returned purchases	2,000.00
(3) For returned sales	1,000.00	(c) For purchases rebates and allowances	100.00
(4) For sales rebates and allowances	500.00	(d) For goods on hand at end	8,000.00

The account is now a pure proprietorship account, the balance showing the amount of gross or first profit on sales, amounting to $3,600.

Modern Practice in Showing Merchandising Transactions

Because actual subtraction is not allowed within the account, the mixed Merchandise account does not show the figures representing "net purchases," "net sales," "total goods to be accounted for," and "cost of goods sold"—information which is very essential to proper management. While containing all the data necessary to give the final

information, viz., the "gross profit," it does not show the separate factors leading up to it. Analysis of the account is necessary to find the elements of which it is composed. The best accounting practice provides for this analysis in the first place. It no longer uses the old Merchandise account; in its place separate accounts are set up, representing the various elements mentioned above. Each account thus contains only one kind of item as indicated by its title. The different accounts are:

(1) MERCHANDISE INVENTORY

(2) PURCHASES

(3) INWARD FREIGHT AND DRAYAGE

(4) RETURNED PURCHASES

(5) PURCHASES REBATES AND ALLOWANCES

(6)	SALES

(7)	RETURNED SALES

(8)	SALES REBATES AND ALLOWANCES

Accounts 1, 2, 3, 7, and 8 correspond to the four classes of debits shown above in the mixed Merchandise account, and accounts 1, 4, 5, and 6 correspond to the credits. Explanation of the use of account 1 for both the initial and final inventories is given in detail in Chapter XVI. The advantage of the use of these accounts instead of the one Merchandise account is seen to be in the availability of the information contained by them and the saving of labor because now there is no need of analyzing the Merchandise account to secure the information. By later transferring the totals of the Returned Sales and of the Sales Rebates and Allowances to the Sales account, the balance of this account will show the "net sales." A similar transfer of the Inward Freight and Drayage, the Returned Purchases, and the Purchases Rebates and Allowances to the Purchases account, and a transfer to it of the initial and final inventories, make it show by its balance the "cost of goods sold" which set over against "net sales" shows the figure of "gross profit."

Accounts with Assets Subject to Depreciation

Another kind of mixed account requiring explanation is that of the fixed asset subject to depreciation. Due to ordinary wear and tear, most fixed assets lose part of their value as time goes by. At the end of each fiscal period the amount of this loss and the present value of the asset are estimated. This is called an appraisal. The difference between an inventory and an appraisal is that in taking an inventory we must find the quantity or number of units of a given asset and multiply this by the unit value, the value being a known factor. In the appraisal, however, the quantity or number of units is known, but the value must be determined or estimated. We speak of an inventory of merchandise or small tools, but an appraisal of real estate, machinery, or other similar items. The difference between the present appraised value of the asset and its former value constitutes the loss through wear or other causes, and is termed depreciation. Since depreciation takes place day by day but for practical reasons cannot be recorded every day, these fixed asset accounts as they stand valued in the ledger represent true asset values only for the date of their entry. These accounts, then, except for that date, include depreciation, and hence are mixed accounts, including both asset and proprietorship elements. Just as with the Merchandise account, an adjustment is made periodically to separate the two elements. Since the asset account is a debit account, entry of the amount of the depreciation to the credit side would result in the account's showing, by its balance, the appraised value of the asset at any given time. If, however, it is desired to leave the account in its original condition, in order not to lose sight of the cost of the asset, this figure of depreciation should be entered to the credit of a separate account called Depreciation Reserve for the particular asset, using the word "reserve" in the sense of

"estimate." If the latter method is followed, each asset has two accounts, the one showing original cost and the other estimated depreciation, it being necessary for a true valuation of the asset to read the two accounts together. Because of this, the reserve account is often called a valuation account or an offset account, as it gives the amount of the offset to the original asset account necessary to show its correct value. Similarly, when an increment in the value of an asset is kept separate from its face or par value—as when we show the premium paid for stock or bonds separately from the par value of the stock or bond—the account showing the increment is called an adjunct account and must be read with the asset account to secure true valuation. The offset account is then a subtraction item and the adjunct an addition item to the corresponding asset account. The showing of the asset and its periodic valuation is made as follows:

MACHINERY

1915 Jan. 1..............$5,000.00	

DEPRECIATION RESERVE MACHINERY

	1915 Dec. 31................$500.00 1916 Dec. 31................ 500.00

A reading of the two accounts shows the original value of machinery as $5,000, the value after one year's use $4,500, after two year's use $4,000. The contra debit for the credit in the reserve account is made to an account called Depreciation, which represents the negative pro-

prietorship or expense element. Sometimes this charge is made direct to Profit and Loss, as will be shown in a later chapter.

Capital and Revenue Expenditures

In connection with fixed asset accounts, which usually show the investment of some of the original capital and therefore are sometimes called capital asset accounts, a fundamental distinction must be made between expenditures for the asset itself and expenditures for expenses in connection with the asset. These two classes of expenditures are usually called capital expenditures and revenue expenditures. The asset account itself is chargeable with all costs incurred up to the point of putting the asset in shape for use in the business. It may be charged also with subsequent expenditures resulting in an increase in the value of the asset. All expenditures, however, which are for the purpose of repairs or of keeping the property from too rapid depreciation without adding anything to its original value, must be charged to a properly labeled expense account. These revenue expenditures are subtractions from proprietorship, while asset expenditures simply constitute an exchange of assets which has no effect on proprietorship. Sometimes two items of expenditure seemingly are of the same nature, while in fact they belong to separate groups, as the original painting cost of a building and a cost incurred at a later period for repainting. In the first instance it is an asset, a part of the original cost necessary to put the building in a finished condition; in the other instance, it is an expense necessary to maintain it in something near its original condition. In order to secure accuracy and truth in the records, careful discrimination between capital expenditures and revenue expenditures is a matter of great importance.

Problems

(*Assignment for Chapter XIV*)

1. Sales for the year were $50,000; returns $2,500; inventory at beginning $8,000; purchases $40,000; returns $4,000; sales rebates and allowances $250; purchases rebates and allowances $325; freight and drayage-in $560. Show the above correctly entered on the ledger in the various merchandise accounts.

2. MERCHANDISE

Inventory	$4,000.00	Sales	$10,000.00
Purchases	2,500.00	Discount	300.00
Discount	120.00	Returns	200.00
Freight	300.00	Sales	1,275.00
Returns	450.00	Sales	3,750.00
Purchases	6,250.00	Rebate	50.00
Duty	250.00	Discount	420.00
Allowances	365.00	Sales	8,960.00
Discount	75.00	Allowances	75.00
Purchases	10,790.00	Discount	163.00
Returns	420.00	Sales	9,475.00
Drayage	175.00	Rebate	15.00
Rebate	69.00	Returns	590.00

Show these items correctly on the ledger.

3. Furniture and Fixture account shows a cash cost of $2,500, sales for cash at cost of $250. At the end of the fiscal period depreciation estimate is 12½%. Show the data on the ledger, setting up both the debits and the credits.

4. Loose Tools account shows a cost of $375, and inventory shows $300 on hand. Show the Loose Tools account on the ledger.

5. Machinery shows cost of $10,000, additions and betterments of $2,000, sales at cost price of $1,500 during the first year, and loss by explosion of $3,000 during the second year. Depreciation is estimated at 10% on a reducing basis. Show Machinery and its appraisal accounts at the end of the third fiscal period.

Instructions

Problem 1. Do not treat the data given as transactions for debit and credit analysis; simply set up the particular accounts as they would appear for record of the above data.

Problem 2. In addition to the various merchandise accounts needed, set up accounts with Sales Discount and Purchase Discount.

Problem 5. Where depreciation is estimated on a reducing basis, the balance of the account at the end of the year minus the balance in the reserve account becomes the basis for calculating the depreciation for the current year.

CHAPTER XV

PERIODIC WORK ON THE LEDGER

The Trial Balance

The work preliminary to summarizing the transactions for a period and to the preparation of financial and profit and loss statements is comprised under three heads: the Trial Balance, Adjusting Entries, and Closing Entries. These will be briefly discussed here, leaving fuller treatment for subsequent handling. When all the transactions for the period have been entered on the ledger, it is desirable to make sure that the ledger is in equilibrium, i.e., that for every entry on the debit side there has been an equal credit and for every credit entry an equal debit. This proof of the mathematical correctness of the ledger is accomplished by means of a device called the "Trial Balance," which is a list either of account totals or of account balances, debit and credit, for all the accounts. If the total debits of all the accounts in this list equal the total credits, then the mathematical equilibrium is demonstrated. A trial balance is usually set up somewhat as follows:

TRIAL BALANCE, JUNE 30, 1916

	Dr.	Cr.
Cash	$1,000.00	
Notes Receivable	1,500.00	
A. B. Casey	500.00	
B. C. Darby	450.00	
C. D. Ebbets	200.00	
D. E. Field	300.00	
E. F. Gall	150.00	

F. G. Hiller	350.00	
Merchandise Inventory	4,000.00	
Delivery Equipment	500.00	
Depreciation Reserve Delivery Equipment		$ 75.00
Notes Payable		1,000.00
Hill & Innes		350.00
Jones & Kanter		175.00
Lunt & Mason		200.00
Noble & Oberly		150.00
P. I. Richards, Capital		5,000.00
P. I. Richards, Personal	1,000.00	
Sales		20,000.00
Purchases	12,000.00	
Salaries	2,500.00	
Insurance	500.00	
General Expenses	2,000.00	
	$26,950.00	$26,950.00

Work Preliminary to the Trial Balance

Preliminary to the taking of a trial balance, the accounts should be totaled. These totals are shown at this time in small but legible pencil figures immediately beneath the last entry on each side, care being exercised to leave sufficient space for a regular entry on the same line, at the top of which appears the pencil footing. Reference to the illustration on the next page will make this clear.

Balancing an Account

Sometimes it is desirable, as in the cash account, to show on the face of the account the difference between the total debits and credits, i.e., the balance of the account. This may be accomplished by writing this balance on the side showing the smaller total, and by formally ruling up the account and entering in ink the totals on both sides, these totals, of course, now showing equal amounts. On the next line below the ruling the balance item is brought down to its

Cash

1916 July	1	A. Rowe, Investment		5000 00	1916 July	1	Rent		50 00
	2	Sales for Cash		595 25		2	Office Expenses		72 25
	3	Notes Receivable		250 00		3	Purchases		3127 50
		Interest on Note		2 50		4	Freight		25 75
	6	A.B. Snyder		36 75		5	Horse		150 00
				5884 50		6	Wagon		75 00
							A. Rowe, Personal		15 00
							Clerk Hire		17 00
									3532 50
							Balance		2352 00
				5884 50					5884 50
July	8	Balance		2352 00					

Account Balanced and Ruled

proper side. The account is said to have been *closed* as to all items above the rulings and shows its open balance in the one item beneath the rulings. To illustrate the method of balancing and ruling accounts the cash account is shown on page 99.

The small footings in the debit and credit columns are to be inserted with pencil. As explained above, these pencil footings should be placed close to the preceding amount so as to leave room for entry of another item on the line just below.

It is important to bear in mind that, as has been stated above, the closing balance of the account is on the side showing the smaller pencil total, but the opening balance which appears beneath the ruling is on the opposite side, the only purpose of the entry on the smaller side being to force an equality of the two sides and therefore allow a formal closing off of all the entries to that point and a showing of the "Balance" as a single item in the new portion of the account.

It should be noticed that this "balance" entry does not disturb the equilibrium of the books, because it is entered on both the debit and credit side of the same account.

Use of Red Ink

The closing rulings and the balancing entry are sometimes in red, although there seems to be a tendency at the present time to disregard the use of red ink entirely, except to show subtraction items, which, if they were entered in black ink, would be added. The necessity of changing pen and ink would work against the highest efficiency of the clerk if measured by the number of items recorded in a given time, but it is to be doubted if red ink entries are ever so numerous as to handicap him seriously in the long run.

Rulings

The lines above the totals, which indicate the addition, extend only through the money columns and are on the same horizontal line on both sides, debit and credit. The closing rulings beneath the footings are double and extend through the date columns, the money columns, and the posting reference columns. The diagonal line on the debit side from the total line to the date column for the last entry is for the purpose of filling all blank lines, thus preventing entries therein after the account is formally closed. Such entries, if made, would have the effect of falsifying the totals shown, and the diagonal line through the blank lines, which may be on either the debit or credit side, is intended as a safeguard against fraud.

Transferring

When, for any reason, it is desirable to transfer an account from one page to another, it is done by means of an entry similar to the "balance" entry shown above. Instead of the word "Balance," the word "Transfer" or "Forward" is used, and in the column between the explanation and money columns is entered the number of the page to which the transfer is made. On that page, the account name appears, and as its first entry the amount transferred from the old account with a page reference to the old account in the "reference" column. In transferring an account from one page to another, it is customary to close that portion of the account on the old page in the manner explained above and to transfer only the balance.

Sometimes only one of the entries in an account is to be transferred because of its having been recorded there in error or for other reason. Assuming, for the purpose of illustration, that it is a credit item, this amount is first written as a subtraction item on the debit side in the old

Cash — Page 8

1916 Jan.	6	Balance		3216 90	1916 Jan.	6	Salaries		125 00
	7	R. C. Hill		72 50		7	Stamps		5 00
	8	Notes Receivable		375 00		8	Telephone		6 25
	9	Interest		3 75		9	A. B. Smith		2162 40
	10	School Bonds		1065 00		10	Charity		10 00
				4732 55			Scott Dry Goods Co		569 50
							Freight In		12 73
									2890 88
		Forward to page	125	4732 55			Forward to page	125	2890 88

Cash — Page 125

1916 Jan.	10	Forward from page	8	4732 55	1916 Jan.	10	Forward from page	8	2890 88

Transfer of Account to New Page

account, with proper reference to the page to which it goes. On the new page it appears on the credit side, like the original item, and may be considered as a contra to its transfer record in the old account. In the new account the old page number must be entered. Great care should be exercised in all transfer entries to show correct cross-indexing.

Sometimes it is desired to transfer not the balance of an account but the total debits and total credits as such. In this case the total debits amount may be entered on the credit side of the old account and the total credits amount on the debit side with proper page and explanatory references. This forces the equality of the two sides and the account may now be totaled and ruled off. The total debits amount of the old account is then entered on the debit side of the new account and the total credits amount, on the credit side.

A much simpler and more workable method, however, is to treat the new account as a continuation of the old. There is then no necessity of formally balancing the old account. Total both sides and indicate the new page to which these totals are transferred, enter the totals on the proper side of the new account, and the transfer is effected. (See illustration on page 102.)

Summarizing the Ledger

After the temporary proprietorship accounts have served their purpose by showing the day-to-day changes in proprietorship, at the close of the fiscal period results must be summed up and the temporary accounts closed for the current period so as to keep the records for this period separate from those of the next. For the purpose of summarizing the ledger, as distinguished from the formal *statements* of summarization, an *account* called Profit and Loss is opened in the ledger and to it are transferred, in the manner shown

above, the balances of all temporary proprietorship accounts. On the credit side of Profit and Loss will appear all credit or income account balances, and on the debit side will appear all debit or expense account balances. For this reason, if the balance of the Profit and Loss account is a credit balance, it shows a net profit for the period; if a debit balance it shows a net loss for the period.

The net profit or net loss of the Profit and Loss account is either an increase or decrease in proprietorship and, belonging to the owner, is transferred to his Personal account. because that account usually shows his drawings during the period against these profits as they were accruing. The Personal account will then indicate whether the amount he has drawn out is larger or smaller than the net profits as determined by the Profit and Loss account. If his profits are larger than his drawings, the net effect for the period is an increase in his capital and this balance of the Personal account will be transferred to the credit side of his Capital account which will then show the net worth of the business. If the drawings are larger than the profits, there is a decrease in capital and this item is transferred to the debit side of the Capital account, thus reducing the original Capital amount.

The summarization of results at the close of a period is called "closing the ledger." It consists merely in a transfer of the temporary proprietorship accounts to the Profit and Loss account, whose balance is transferred to the owner's Personal account, the balance of which is in turn transferred to the owner's Capital account. Unless there be deferred or accrued elements (the handling of which will be shown in the next chapter), all temporary proprietorship accounts, the Profit and Loss account, and owner's Personal account, after being transferred to some other account, will balance and are formally ruled off. The accounts now remaining open on the ledger show either assets, liabilities, or capital.

Rulings and Entries in Personal and Note Accounts

Reverting to the method of ruling, some peculiarities met with in ruling personal and note accounts both receivable and payable, will be discussed here.

In John Adams' personal account (page 106) notice the inclusion of address. The terms of credit extended to him on each sale are shown in the explanation space. The payments made by him are entered according to the date on which they are received, and if the payment item appears opposite the corresponding charge, with no other credits intervening, lines are ruled underneath both the debit and the credit items, showing that down to that point the account balances. The record of the dealings with each customer should be as full as possible in order to furnish an accurate basis for credit rating. If he is prompt in his payments, taking advantage of the discounts offered him, the account should show it.

A convenient method of showing clearly the taking of discounts, without the need of calculating the time between dates of charge and payment, is by entering the discount in small ink figures above net amount received. When partial payments are made as on October 1 and 15 in sums sufficient to settle the charge of September 20, and there are no other credits intervening, the two credits, with the total in small figures, may be ruled off against the single charge. At the time the trial balance is taken—in the illustration on August 31, September 30, and October 31—the balance of the account is calculated and shown in pencil on its proper side, debit or credit, just to the left of the reference column on the line of the last entry on that side.

Sometimes, when payments are out of order or on account and it is desired to show to what particular charges they apply, use is made of an index number or letter showing the cross reference, as shown on the Notes Payable

John Adams
125 So. Michigan Blvd., Chicago, Ill.

1916 Aug.	25	2/10, n/30	250.00		250.00	1916 Sept.	21				250.00
Sept.	14	2/10, n/30			510.00		23				10.20 / 499.80
	20	1/5, n/30	389.20		389.20	Oct.	1				810.00 / 300.00
Oct.	10	2/10, n/60			1,253.30		15				89.20
	19	1/5, n/30	1327.80		74.50 / 1327.80	Nov.	5				389.20 / 750.00

Notes Payable

1916 Aug.	14			567.20	1916 July	14				567.20
	2			250.00		25	817.20			250.00
	25			817.20 / 1225.00	Aug.	10				817.20 / 1225.00
						19	213.25			213.25

Personal and Notes Payable Accounts

account. As notes are issued they may be numbered, and when a particular note is paid by us, the entry covering this payment should show the number of that note. These remarks apply also to notes receivable. If full payment is made on each note as it comes due, entry of the payment may be made on the same line on which its issuance was recorded. This may result in the entries to the account appearing out of chronological order, but it assists in an easy determination of the outstanding notes. Numbering, or preferably lettering, the entries in an account may be applied with advantage also to personal accounts as it aids in locating unpaid items, especially where payments cannot be recorded in the order in which the items to be settled were entered.

The method of *ruling* cancelling items as explained above is usually limited to notes and accounts receivable and payable. On the other hand, it is advisable that the method of *showing balances* for use in the trial balance be applied to all accounts.

Problems

(*Assignment for Chapter XV*)

1. Set up the ledger account called for in Chapter XIII, Problem 3, and show the account closed and the new accounts called for in Chapter XIII, Problem 4, properly set up. (Be sure to make cross reference to pages and show the transfers between the several accounts.)

2. Allowing five lines for each account and for the necessary depreciation reserve accounts which should follow immediately their particular assets, under date of December 31, 1916, set up the following accounts on the ledger, in proper form and under correct titles, and take a trial balance. T. C. Counts, investment $11,635; withdrawals

$900; purchases $12,300; sales $11,850; cash $1,040; furniture $2,100; notes receivable $1,300; notes payable, Dr. $590, Cr. $2,400; accounts receivable $3,210; horses and wagons $1,940; freight and drayage-in $128; insurance and taxes $205; interest and discount, Dr. $42; expenses $850; wages $1,280.

Prepare financial and profit and loss statements using these inventories and appraisals: merchandise $7,500; furniture $2,000; horses and wagons $1,700; insurance unexpired $45; and expense supplies $170.

Instructions

Problem 1. Follow the forms and instructions for transferring given in the text.

Problem 2. Be sure to enter the amounts on the correct sides of the accounts. Record the trial balance on a piece of journal paper.

CHAPTER XVI

TREATMENT OF INVENTORIES AND APPRAISALS

Why the Current Record of the Ledger Needs Adjustment

At the end of the fiscal period the record on the ledger is not a true record of financial condition, because no record has been kept of the cost of goods sold and no current record has been made of depreciation nor of certain other items of expense and income as they accrue from day to day. For this reason the ledger must be adjusted to bring it into accord with actual conditions. The entries required for this purpose are called adjustment entries.

Whether the merchandise items are kept in one or in several accounts, these do not show the amount of stock on hand at any given time *during* a fiscal period. Similarly, expenses are not usually entered on the books until paid, nor do income items appear before their receipt. It may be that the services paid for during this period, as shown by the various expense accounts, have not been entirely used up, as where there remains on hand a supply of coal for heating purposes, or as in the case of insurance paid in advance for a given period of time, a part of which extends beyond the close of the current fiscal period. In these and similar cases, the items actually paid must be separated into their two component elements, one part belonging to the current period, and the other part deferred until used in a later period. Similarly, income is sometimes received in advance to cover services which have not yet been rendered or which have been rendered only in

part, as where rent is received in advance covering a given number of months, some of which belong to the next fiscal period. Consequently, only a part of this income applies to the current period, while the balance must be deferred to later periods.

Basis of Adjustment Entries

These items, then, comprising merchandise, depreciation of assets, and prepaid and accrued expenses and income, form the basis for the adjustment entries. We take an inventory to find the value of the stock in trade; we make an appraisal of depreciating assets and thereby determine the amount of depreciation for the current period; and we prorate on an equitable basis the prepaid and accrued income and expense items to determine the portions applicable to the period under review. The following illustrations covering each class of adjustment entries separately, will help to clarify the above discussion. The detail of the account will not be shown, but only the totals as given in the trial balance.

Adjusting and Closing the Merchandise Records

The first illustration will cover the case where the transactions affecting merchandise are kept under the separate accounts with Merchandise Inventory, Purchases, Freight In, Returned Purchases, Purchases Rebates and Allowances, Sales, Returned Sales, and Sales Rebates and Allowances. The inventory taken June 30 showed merchandise then on hand, $11,267.40.

MERCHANDISE INVENTORY

1916			1916		
Jan. 1		$10,125.67	June 30 Purchases	(B)	$10,125.67
June 30	(E)	11,267.40			

Purchases

1916			1916		
June 30	(Total purchases)	$47,897.42	June 30	Returned Purchases (C)	$2,125.40
	Freight In (A)	560.25		Pur. Rebates and Allow. (D)	267.92
	Mdse. Inventory, Jan. 1 ... (B)	10,125.67		Inventory, June 30 .. (E)	11,267.40
				Profit and Loss ..... (F)	44,922.62
		$58,583.34			$58,583.34

Freight In

1916			1916		
June 30	(Total)..........	$560.25	June 30	Purchases.... (A)	$560.25

Returned Purchases

1916			1916		
June 30	Purchases.. (C)	$2,125.40	June 30	(Total).........	$2,125.40

Purchases Rebates and Allowances

1916			1916		
June 30	Purchases.... (D)	$267.92	June 30	(Total)..........	$267.92

Sales

1916			1916		
June 30	Returned Sales .... (G)	$3,924.83	June 30	(Total).......	$65,283.21
	Sales Rebates and Allow.... (H)	392.48			
	Profit and Loss ...... (I)	60,965.90			
		$65,283.21			$65,283.21

Returned Sales

1916		1916	
June 30 (Total)........	$3,924.83	June 30 Sales ......(G)	$3,924.83

Sales Rebates and Allowances

1916		1916	
June 30 (Total)..........	$392.48	June 30 Sales........(H)	$392.48

Profit and Loss

1916		1916	
June 30 Purchases .(F)	$44,922.62	June 30 Sales......(I)	$60,965.90

In order to understand the entries, note that the first debit entries in the Merchandise Inventory, Purchases, Freight In, Returned Sales, and Sales Rebates and Allowances, and the first credit entries in Returned Purchases, Purchases Rebates and Allowances, and Sales accounts, are trial balance totals. All other entries are adjustment or closing entries. In the illustration, a given letter is used for the purpose of indicating corresponding entries.

To show the total cost of goods bought during the period, the Freight In of $560.25 is transferred or closed into Purchases. To show the "*gross* cost of goods to be accounted for," amounting to $58,583.34, the inventory of January 1 of $10,125.67 is closed into the debit side of Purchases account. To show the *net* cost of goods to be accounted for, the Returned Purchases and Allowances must be deducted from this gross cost and are therefore transferred to the credit side of Purchases. The balance of Purchases account at this point, viz., $58,583.34 minus $2,393.32, or $56,190.02, would indicate the net cost of

goods to be accounted for. This item of $56,190.02 is not indicated in the account, however, but given here in order to make the discussion intelligible. Part of this $56,190.02 (net cost of goods to be accounted for), amounting to $11,267.40, is the cost value of the unsold goods according to the inventory of June 30, and the balance of $44,922.62 ($56,190.02 minus $11,267.40) therefore constitutes the *cost of the goods sold.* This final inventory is also shown as an asset on the debit side of Merchandise Inventory.

Put in a somewhat different form, we may say that the cost of goods sold is found by subtracting from the gross cost of goods to be accounted for, $58,583.34, the returns and the rebates, $2,393.32, and by further subtracting from it the amount of the closing inventory of June 30, $11,267.40; leaving a balance of $44,922.62, which represents the *cost of goods sold.* This balance is now transferred to the debit of Profit and Loss account.

It would be equally effective, however, to transfer this balance to the debit of Sales, but since the Profit and Loss shows all other costs of the business, it seems more logical to show also therein the cost of goods sold. All of the transfer entries given above have their debits and credits determined as explained in Chapter XV.

The Sales account is debited with the balances of the Returned Sales and Sales Rebates and Allowances, thus indicating a balance of net income from sales which is transferred to the credit of Profit and Loss. This account then shows net income from sales on the credit side, and cost of goods sold on the debit side, the balance being gross profit on sales. If, as is sometimes done, the cost of goods sold were transferred from the Purchases account to the Sales account, instead of to Profit and Loss, the balance of the *Sales* account would show gross profit on sales and should be transferred to the credit of Profit and Loss. All

of the merchandise accounts, except the Inventory account, are thus balanced, and should be ruled off.

The second illustration will cover the case where the stock-in-trade record is kept in one mixed account called Merchandise. Using the same data as before, that account will show as follows:

MERCHANDISE

1916			1916		
Jan. 1	Inventory	$10,125.67	June 30	Sales	$65,283.21
June 30	Purchases	47,897.42		Returned Purchases	2,125.40
	Returned Sales.	3,924.83		Purchases Rebates and Allow.	267.92
	Sales Rebates and Allow....	392.48		Inventory, June 30	11,267.40
	Freight In......	560.25			
	Profit and Loss	16,043.28			
		$78,943.93			$78,943.93
June 30	Inventory	$11,267.40			

When the merchandise is kept under separate accounts, the Freight In is *transferred* to the debit of the Purchases account, but when a single mixed account is kept, it is usually entered directly to the debit of that account. For adjusting the account when kept in this manner, the new inventory is entered to the credit of Merchandise. The balance of the Merchandise account now shows the gross profit on sales, $16,043.28. This is transferred to the credit of Profit and Loss. It will be noted that this *transferred* item is identical with the *balance* of the Profit and Loss account of the first illustration. The Merchandise account is now totaled and ruled off. On the debit side, beneath the ruling, the new inventory is entered, this being the contra to the credit entry of $11,267.40 above the ruling,

and so maintaining the equilibrium of debits and credits. In this open item of $11,267.40 the account shows an asset, the goods on hand June 30.

The handling of merchandise transactions according to the second illustration is not considered good accounting but is shown because it is frequently met with.

Handling Depreciation on Fixed Assets

The method of handling depreciation on assets is shown in the following illustration:

FURNITURE AND FIXTURES

1916 Jan. 1 .... $750.00	

DEPRECIATION RESERVE FOR FURNITURE AND FIXTURES

	1916 Dec. 31 ....(A) $75.00

DEPRECIATION

1916 Dec. 31 ....(A) $75.00	

The asset Furniture and Fixtures, valued at $750 at the beginning of the year is estimated by appraisal to have depreciated 10%, or $75, during the year. This cost or expense is charged to an account called Depreciation, and credited not to Furniture and Fixtures, but to the valuation account "Depreciation Reserve for Furniture and Fixtures." The Furniture account and its valuation account, *taken together,* show the appraisal value of $675. The Depreciation account, carrying the debit of $75, is an expense account and is to be closed into Profit and Loss, just as are all other expense accounts.

Handling Prepaid and Accrued Expenses and Income

The method of handling the estimates or inventories of prepaid and accrued expenses and income is very similar to that shown for the mixed Merchandise account. Illustrations follow:

INSURANCE

1916		1916	
Jan. 1 (Paid)............	$150.00	June 30 Unexpired	$125.00
		Profit and Loss..	25.00
	$150.00		$150.00
July 1....................	$125.00		

RENT INCOME

1916		1916	
June 30 Unearned	$250.00	June 15 (Received)......	$300.00
Profit and Loss..	50.00		
	$300.00		$300.00
		July 1..................	$250.00

WAGES

1916		1916	
June 30 (Paid).........	$2,125.00	June 30 Profit and Loss	$2,325.00
Accrued, Unpaid	$200.00		
	$2,325.00		$2,325.00
		July 1 Accrued........	200.00

INTEREST INCOME

1916		1916	
June 30 Profit and Loss..	$145.00	June 30 (Received)	$127.50
		Accrued (due us)	17.50
	$145.00		$145.00
July 1....................	$17.50		

The first account, Insurance, is a deferred or prepaid expense account, i.e., the insurance bought was for a three-year term, hence only one-sixth of it is chargeable to the first half-year, the remainder being deferred to later periods. The amount of the inventory or unexpired portion is entered to the credit in order to effect subtraction of the amount, the balance of the account, $25, thereby showing the insurance cost for the current period. This balance is carried to Profit and Loss. After closing the account, the inventory is entered to the debit below the ruling, thus showing the so-called "deferred asset" portion which will appear in the financial statement.

The next account, Rent Income, is a deferred proprietorship income account, i.e., rent has been received for a given period which extends beyond the end of the current fiscal period. On June 15, rent for the period of, say, June 15 to September 15, was received by us. Only one-sixth of this income applies to the term January 1 to June 30; therefore, the balance of $250 must be deferred or carried over to the next fiscal period. The adjustment is made by an entry of $250 for unearned rent, on the debit side to effect subtraction of it, thereby reducing the earnings for the current period to $50. This income of $50 is transferred to the credit of the Profit and Loss account. After the account is ruled off, the deferred income is entered

below the ruling on the credit side, forming a part of the earnings of the next period. This deferred item will be shown among the liabilities in the financial statement for the current period.

The third account, Wages, shows wages paid to June 30 of $2,125. At that date wages earned but not yet paid, perhaps because the pay day did not coincide with the date of closing the books, amounted to $200 and this must be included as an expense of the current period. This item directly applies to the short interval between the last pay-day in June and June 30. The $200 is therefore entered on the debit to effect *addition* of it to the expense already shown there. The full amount is transferred to Profit and Loss; the account is ruled off; and the amount of unpaid wages, $200, is shown on the credit beneath the ruling, and appears as a liability in the financial statement.

Similarly with the fourth account, Interest Income. Income to date is $127.50; earned but not yet due on June 30, $17.50, showing full earnings of $145 for the current period. This total is transferred to Profit and Loss; the account is ruled off; and the earned, but not received portion, is shown as a debit beneath the ruling, and as an asset in the financial statement.

Great care must be exercised in all inventories of any kind to maintain the equilibrium of the ledger by entry of each amount to both the debit and credit sides.

Besides the four illustrations given above, there are many other accounts requiring the same kind of adjustment entries. In certain special cases it may be necessary to make adjustments on both sides, as for example in a general expense account or in a mixed interest account showing both interest income and interest expense. For illustration:

Interest

1916			1916		
June 30	(Paid)	$400.00	June 30	(Received)	$500.00
30	(Unpaid)	50.00	30	(Accrued) (due us)	100.00
30	Profit and Loss..	150.00			
		$600.00			$600.00
July 1	Accrued..........	$100.00	July 1	Unpaid...........	$50.00

The opening item of $100 represents an asset, an interest claim against outsiders, while the credit opening item of $50 represents the liability to others for interest due them but not yet paid.

Problems

(Assignment for Chapter XVI)

1. Give two examples each of deferred expense and income and accrued expense and income. Show these set up in account form.

2. Assuming an inventory of $2,500 for Problem 2, Chapter XIV, as correctly set up, show the merchandise accounts closed.

3. Close the ledger for Problem 2, Chapter XV.

Instructions

Problem 1. Follow the account forms shown in the text.

Problem 2. Study carefully the transfers made in closing the various merchandise accounts illustrated in the text; then solve Problem 2.

Problem 3. Refer to page 103, "Summarizing the Ledger," for the method of closing the accounts into Profit and Loss. Be careful to make both debit and credit entry for every transfer. Be sure to handle the inventories and deferred expense items before making the transfers to Profit and Loss. Rule up carefully all transferred accounts; make no rulings in the other accounts.

CHAPTER XVII

SOURCES OF DATA FOR THE LEDGER

Insufficiency of the Ledger Record

In an earlier chapter a business transaction was defined as an exchange of values; the ledger, as the book in which transactions are grouped under predetermined titles or names. Thus, all transactions relating to machinery are grouped under the title "Machinery"; those relating to cash under the title of "Cash"; those to purchases under the name "Purchases"; etc. Even in a small business the ledger may contain a large number of accounts, all necessary to give a clear-cut presentation of the volume and significance of business transactions.

The ledger record presents an analysis of transactions into their component elements, each transaction being classified and recorded, usually, in at least two, and frequently more, ledger accounts. Consequently, in order to learn the nature of a given transaction, to see it in its entirety, it may be necessary to refer to a number of separate ledger accounts. This process, even if the ledger is small, is not always an easy matter; and when the ledger contains a large number of accounts, it becomes practically impossible. Accordingly, another kind of record is needed.

The Book of First Record

This other record shows the transaction in its entirety; it gives a complete statement of the conditions and all other data relating to it, and also shows its fundamental analysis under appropriate titles. This record is called the original or first record. Usually it is not the very first record

made of the transaction but it is the first record made in the books of account. The book in which this record is kept is called the "Journal." The record as kept in the ledger is a secondary record based on the original or first record in the journal. Because of its secondary nature, courts will not accept the ledger as evidence without verification.

Posting to the Ledger

The act of transferring the original entry into the ledger is called posting to the ledger. In order not to lose sight of the original record in the journal, it is important that the ledger entry show by letter and number the book and page where the original entry can be found. This index is entered in what is called the reference column of the ledger account, the column just to the left of the money column, thus affording for every entry in a ledger account a reference to the original entry pertaining thereto.

The Journal

A journal may be defined as a diary or log in which the happenings or transactions of a business are recorded. Formerly it was sometimes called a day-book or blotter. The day-book or blotter record was a rough record giving all the essential data relating to each transaction without regard to accounting terminology, and was used as a sort of memorandum from which a formal record might be made in accounting terminology. This day-book or blotter, still in use in some places, has very largely given place to the journal which, either a single book or separated into many subsidiary books, is the book of original entry.

Characteristics of the Journal

1. Being of the nature of a diary, the journal shows all of the day's transactions in consecutive order with little

regard to grouping. The first characteristic, therefore, of the journal is that it is a book of chronological entry, a record of each transaction just as it took place and entered according to its date.

2. Another characteristic of the journal entry is that it is an analytical and classifying record. Before the entry is made, the transaction is analyzed as to its two elements of debit and credit, determined according to its effect as to increases and decreases on assets, liabilities, or proprietorship. The account titles used in the journal are selected on the basis of a detailed sub-classification of the three fundamental groups mentioned above. The degree of detail in classification depends on the desired minuteness of the information required. The guiding principle in giving these titles is to use such names as will tell truthfully and accurately what kind of information is recorded under each head. A journal entry is therefore an analytical record as to debit and credit, classifying the different elements of the transaction under such titles as will later be used in the ledger.

3. A final and a very essential characteristic of the journal is that every entry should carry in addition to account titles, with their debit and credit amounts, a brief but complete summary of all the conditions and data relating to the transaction, so that, if reference to it may be made in the future, the journal record will call to mind the essentials of the entire transaction. Because of these three characteristics—particularly the last two—the journal record is one of prime importance.

Equilibrium of the Journal Entry; Compound Entries

As has been discussed in a previous chapter, all transactions, when analyzed as to their debit and credit elements, must show equal amounts on the debit and on

the credit. Since the journal entry is such an analysis of the transaction, it is plain that it must show equal amounts in the debit and credit columns. In case the analysis and classification require an entry consisting of more than one debit and one credit item, the total of the several debit items must be equal to the total of the credit items. Such an entry is called a compound journal entry.

Standard Form of Journal

The standard form of journal must provide spaces for the following information: date, classification as to debit and credit, ledger index column, money columns to show both the debit and credit amounts, and full record of the essentials of the transaction. The following form illustrates a complete journal entry:

1917					
Jan. 10	James Jackson		10	$512.50	
	Sales		21		$512.50
	Terms 2/10, n/30				
	10 desks	$400.00			
	12 racks	90.00			
	15 chairs	22.50			

The date is sometimes shown in the middle of the first blank line, but it is better to place it at the extreme left. The account titles are each placed on a separate line unencumbered with other data, because they are of first importance in posting. The name of the debit account is shown on the extreme left of the explanation column, with a uniform margin to the right for the credit. The debit and credit amounts are placed in the left and right money columns respectively. Data as to terms of credit and items of merchandise sold are shown directly below the classified debit and credit entry, slightly to the right of the credit ac-

count title margin, maintaining a uniform margin down the page. The column to the left of the money columns shows the ledger pages to which the entry is posted. The entry is read James Jackson, debit; Sales, credit, $512.50.

Practice Data

(*Assignment for Chapter XVII*)

The following transactions are to be set up, debit and credit, on the ledger. Use the transaction number as the day of the current month. Set up on your ledger the following account titles, in the order given, allotting to each the number of lines indicated by the numeral following the title:

Cash 35
Notes Receivable..............10
Tom J. Dukes..................10
M. J. Scooner..................10
M. J. Smith....................10
J. T. More.....................10
M. I. Quinn....................10
John Cohen.....................10
Stan Edwards..................10
Dan J. O'Shea.................10
Merchandise Inventory........10
Furniture and Fixtures.......10
Notes Payable.................10
Johnson Brown & Co..........10
Jackson & Little...............10
Green-Cooper Company........10
James Black...................10
U. R. Marchand, Capital.......10
U. R. Marchand, Personal......10
Profit and Loss...............15
Purchases 15
Freight In.....................10
Purchases Returns and Allowances 10
Sales 25
Sales Returns and Allowances..10
Salaries 10
General Expense..............15
Expense Supplies..............10
Interest and Discount.........10
Purchases Discount...........10

1. U. R. Marchand invested cash $1,500 and merchandise $1,700.
2. Paid rent $30; bought merchandise of Johnson Brown & Company, $1,340 on account.
3. Sold merchandise for cash $340.25; paid for office stationery, postage, account books, and miscellaneous supplies, $45.75.
4. Sold merchandise $375.20 to Tom J. Dukes, receiving $250 cash.
5. Bought office safe and typewriter $85.

6. Bought merchandise of Jackson & Little, $327.40, paying $200 cash. Gave Johnson Brown & Co. $1,000 on account. Marchand took merchandise for his own use $25.60.
8. Cash sales were $234.69. Paid for advertising $10.
9. Paid clerk $12; fuel bill $22.50.
10. Bought merchandise for cash at receiver's sale $325.
11. Sold Dan J. O'Shea merchandise $35. Took his check in payment.
12. Paid $5 for sales tickets; postage $2.50; envelopes $1.
13. Sold bill of merchandise $175.40 to M. J. Scooner, receiving cash $75.40, P. D. Jacks' note for $35, due in 10 days, and Scooner's note at 30 days for the balance.
15. Gave Johnson Brown & Co. your 10-day note for balance due. Scooner returned $10 worth of the merchandise sold him on the 13th, claiming it inferior in quality.

Instructions

Be sure the date—year, month, and day—is entered. Assume addresses for all personal accounts.

Tangibility is perhaps the best criterion by which to determine whether an item should be handled in a "Supplies" account or in an "Expense" account. If the payment is for a real, tangible thing as distinguished from a service, such as "Wages," or a use, such as rent, telephone, etc., it is best handled in a "Supplies" account. Of course, distinction must be made between merchandise purchases and supplies and also between furniture and fixtures and supplies. Such items therefore, as postage, stationery, fuel, etc., should be treated as supplies.

CHAPTER XVIII

THE SUBDIVISION OF THE JOURNAL

Inadequacy of the Old Journal

As was indicated in the previous chapter, every business transaction formerly was entered in the day-book, or journal as it was later called. This necessitated the making of a formal debit and credit entry for every transaction, many of which were of the same or a similar kind. Accordingly, during any business day, a large number of sales had each to be analyzed, classified, and entered separately. The entry in each case was a debit to the customer and a credit to Sales, if the sale was "on time"; or a debit to Cash and a Credit to Sales, in the case of a cash transaction. This required a conscious mental effort in each case. It was soon perceived that one entry could be used for bringing into the books all of the sales for a given day. This was accomplished through the use of both a blotter and a journal. The blotter was used as a *memorandum* carrying the data of each individual transaction; the journal as the *formal* record in which was set up at the close of each day a summary of these items, properly indicating the debits and credits. Such a summary or compound journal entry is illustrated below:

A Jackson	$175.00	
D. Hayes	25.00	
J. M. Marshall	132.50	
T. P. Pollard	79.40	
I. M. Cranston	93.20	
M. V. Johnson	17.15	
Sales		$522.25
To record the day's sales.		

In this way the principle of labor-saving was introduced into the journal.

Similarly, throughout the day, there are a large number of cash transactions—receipts and disbursements—which would require a separate debit and credit record for each. Also purchases of merchandise, although not numerous for any particular day, would require a large number of entries when taken for a month or year.

The Subsidiary Journal a Labor-Saving Device

To save the labor of so many entries, the original journal was divided into separate books known as subsidiary journals, each containing the original entries for a particular group of similar transactions, the number of books corresponding to the number of groups into which the various transactions might be divided. For instance, where the policy of the business is to encourage the payment of outstanding customers' accounts by notes from them, the use of a notes receivable book or journal would effect a very appreciable saving of labor. This book being limited absolutely to a record of notes as they are received would, in that system, contain nothing but notes receivable debits. It would not be necessary then to write each time a complete journal entry as follows:

Notes Receivable..................................	$1,500.00	
J. M. Johnson..............................		$1,500.00

when Johnson gave his note to the business, as the record in the notes receivable journal would in itself be evidence of a debit to Notes Receivable account. Thus only the credit side of the entry need be shown, with appropriate explanation and detail, the *formal* debit being suppressed. However, at a posting time the total of all these entries is formally label-

led "Notes Receivable, Dr." and posted to the debit of the Notes Receivable account.

So also, were it the practice of the business to issue many of its own notes either in payment of purchases or for discount purposes, a "Notes Payable Journal" might be used. The method of handling this book would be similar to that described in the preceding paragraph.

Basis of Subdivisions

The basis for dividing the one general journal into subsidiary journals is the frequency of occurrence of transactions of a similar nature. It would be folly evidently to create a subsidiary journal if the number of transactions to be recorded therein were small. The saving of labor in a case like this would be more than offset by the work of using an extra book.

Customary Subdivisions

The subsidiary journals most frequently met with in a majority of businesses are those for purchases, sales, and cash; the purchases journal containing the original entry of purchases, the sales journal recording the sales and the cash book showing all cash transactions. All *other* original entries are made in the general journal. For the sake of briefness, the general journal is usually designated by the single term "Journal."

It should be thoroughly understood that all of these journals combined, the subsidiary and the general, comprise the *journal* record of transactions. None of them is merely a memorandum record to be summarized and to be formally recorded later. The record made in each is formal, although abbreviated, and each must be posted completely, both debit and credit, in order to secure in the ledger a full record of all business transactions.

Practice Data

(*Assignment for Chapter XVIII*)

The following transactions of U. R. Marchand are to be set up on the ledger in the same manner as those given in Practice Data at end of Chapter XVII, using the transaction number as the day of the current month.

16. Cash sales were $395.40. Paid clerk $12.
17. Paid freight and drayage bills $22.30; light bill $5.
18. Drew for private use $25.
19. Bought, on account, 2/10, net/30, merchandise from Green-Cooper Company, $2,500.
20. Cash sales $425.67.
22. Sales on account: M. J. Smith $30; J. T. More $51.20; M. I. Quinn $10.03; John Cohen $43.30; Stan Edwards $69.30.
23. Returned merchandise $200 to Green-Cooper Co. as unsatisfactory.
24. Paid clerk $12; received payment on P. D. Jacks' note and interest 25c. Was allowed by Green-Cooper Co., $10 on damage claim.
25. Paid note, favor Johnson Brown & Co., with interest at 8%. T. J. Dukes pays $75 on account. Paid freight and drayage $25.04.
26. Took merchandise for own use $25.30; sold Dan J. O'Shea merchandise $125, receiving cash $40 and Jack Gibson's 6% 60-day note for $75.
27. Paid telephone bill $2; advertising $8; and bill-heads $5.
29. Allowed D. J. O'Shea $5 claim for goods soiled. Had your note for $1,200 discounted at bank, 60 days at 8%. Paid Green-Cooper Co. amount due them.
30. Cash sales $235; paid clerk $12; fuel $22.50; drew for private use $25. Collections were: M. J. Smith $20; J. T. More $21.20; John Cohen $5; Stan Edwards $25.
31. Paid Jackson & Little $100 on account; cash sales $500; received for the store farm produce $33.50 from Jas. Black, allowing him merchandise $22 and balance credited.

Instructions

19. Terms of sale 2/10, net/30, give the buyer the option of making settlement on two bases, viz., 2% off the face of the bill if paid within 10 days, or the net amount to be paid in 30 days.

29. In discounting a note at the bank, the interest is prepaid by deducting it from the amount of the note. Hence, Marchand secures less cash than the $1,200, to cover interest for 60 days at 8%.

Notice that the Green-Cooper bill is paid within the 10-day limit for discount.

CHAPTER XIX

THE PURCHASE JOURNAL

Explanation will be made, at this point, of the various subsidiary journals, taking them in turn. For recording purchases of stock in trade a separate book or journal is used, limited entirely to such entries. A so-called "Invoice Book," explanation of which is given in a later chapter, is sometimes used for this purpose.

Meaningless Distinction Between Book and Journal

Occasionally an attempt is made to distinguish between the terms book and journal, as applied to these subsidiary records. Where such distinction is made, the "book" seems to carry considerably more detail and might even show an almost complete copy of the purchase invoice. The record in the *journal* does not show such detail; it simply gives the date, amount, and the index number of the purchase invoice. There is no need for a distinction of this sort, for whatever the details of the method of making the record of purchases, the essential characteristic of all the methods of recording is the same—the effect being to do away with the necessity of making a complete double entry for each individual transaction. In this work the terms "journal" and "book" will be used synonymously.

Expanded Use of the Purchase Journal

The purchase journal is not always limited to a record of purchases of stock in trade, but is sometimes used to show all purchases of whatever sort. For example, purchases of store and office supplies, of advertising and

printing, and even of services such as labor, and of uses, such as the use of a building, are sometimes recorded in the purchase journal. When so used it becomes very much like a voucher or accounts payable register which will be explained in Volume II. For the present discussion we will limit the purchase journal to a record of purchases of stock in trade.

Analysis of the Purchase Transaction

The debit and credit analysis of a transaction covering a purchase of stock in trade may result in either of two groups of entries: (1) The debit may be to Purchases and the credit either to a personal account payable or to the Notes Payable account, if the transaction is on credit; or (2) the debit may be to Purchases and the credit to Cash, if the transaction is for cash. At the time of the purchase, in the first case, there is an increase of assets offset by an increase of liabilities; in the second case, an increase of assets offset by a decrease of assets. In neither case is proprietorship affected until after sales take place. The Purchases account, therefore, is a mixed account, representing asset values as on the date of the receipt of the goods purchased, but, after sales occur, some portion of the values in the account represents the cost of the goods sold

The introduction, into the Purchases account, of the inventory of goods on hand at the close of the fiscal period, in order to separate the asset and cost or expense elements, was explained in Chapter XVI. Thus, although the handling of the Purchases *account* is somewhat complicated at the close of the fiscal period, the *original record* of the current transactions is very simple, involving entries adequate to record the analysis made above under the two groups.

The Purchase on Account

All purchases which are made on open account would be recorded in the purchase journal, thereby debiting the Purchases account, with a corresponding credit to the vendor's account, as was explained above under (1). Expressed in journal form, the entry would be as follows:

(a) Purchases
Vendor (account payable)

On the other hand, if at the time of the purchase a note is given to the vendor, the debit and credit of the entry would be as follows:

(b) Purchases
Notes Payable

Where the customary subsidiary journals are used, viz., purchase, sales, and cash journals, neither of the above entries, (a) or (b), requires for its record any other than the purchase journal, as both are pure purchase transactions involving neither sales nor cash. Therefore, both can be completely recorded in the purchase journal.

The Cash Purchase

When purchases are made for cash, the entry, as explained under (2) above, would be:

Purchases
Cash

Here there is evidently a conflict of places of original record. Being a purchases transaction, record should be made in the purchase journal; but being also a cash transaction, record must be made also in the cash book. Were independent record made in both places, the result would

be a duplication of the transaction. It would be twice entered, in full, causing an inflation of the purchases and the cash disbursements. In the purchase journal, only the credit Cash would be set up at the time of the transaction; but at the time of summarization, the debit to Purchases would be included in the total of the Purchases. This makes a complete record of it. However, to show in the cash book all of the cash disbursed, this disbursement must appear therein. In the cash book, only the debit, Purchases, would be set up currently, but when the summary is made the credit to Cash would be shown in the Cash total. This would bring about two duplicate debits and credits for the same transaction. Two methods to overcome the difficulty are commonly employed, as follows:

Handling the Cash Purchase

1. The record is made complete in both journals, the purchase and cash. When posting is done, however, the credit to Cash from the purchase journal record is *not* posted, because that credit will be posted from its record in the cash book. When posting the cash book, the debit to Purchases is *not* posted, because that has already been posted from the purchase journal. In this way *original* record may be made in both journals and each journal will then show by its total what it is intended to show, viz., total purchases and total cash disbursed respectively. In the *secondary* record, the ledger, only half of each journal entry is set up, the debit to Purchases from the purchase journal and the credit to Cash from the cash book. This prevents the inflation mentioned above and does not destroy the equilibrium of the ledger because there is omitted, when posting from the cash book, a debit equal in amount to the credit omitted when posting the purchase journal.

2. Another method of accomplishing the same result is by providing a personal account with the vendor in both journals. Current record in the purchase journal would show, expressing both the debit and credit for the sake of clearness of explanation:

Purchases
    Vendor

In the cash book, record would be, expressed in full:

Vendor
    Cash

When made in this way, it would require opening an account with the vendor for every cash purchase. This is sometimes desirable, in order that the ledger record may thus show the volume of business, both cash and credit, done with each vendor. The same result is sometimes accomplished by the use of only one account called "Sundry Cash Creditors," instead of individual accounts with each vendor, posting thereto both from purchase journal and cash book all such cash purchase transactions.

Usually, however, at posting time no account with the vendor is opened on the ledger, and the credit shown to it in the purchase journal and its debit from the cash book are both omitted. It is customary, when posting, to indicate all omitted postings like the above by entering a check mark, √, or cross, ×, in the ledger folio column of the journal.

Posting the Purchase Journal

The purchase journal, then, contains a complete record of all purchases of stock, and at posting time the total of all the purchases for the period is transferred to the Purchases account in the ledger, thus saving labor not only in the original record but also in posting to the ledger

account. The individual items have already been posted to the credit of the various Accounts Payable accounts in the ledger, indicating the names of the vendors. A daily posting of the individual items is best, in order to keep the individual creditors' accounts right up to date. The daily posting of these credits, of course, throws the ledger out of equilibrium for the time being, but when the summary debit to Purchases account is made periodically, that equilibrium is re-established.

Form and Method of Use of the Purchase Journal

The simplest form of purchase journal is the same as that of the standard journal, providing space for date, classification, ledger index, two money columns, and explanation. In the purchase journal the money columns do not have "debit" and "credit" significance, but the first column may be used for the detailed extensions and the other column for the total of each purchase. Suppose, by way of illustration, that the following purchases have been made, the detail for the first only being given:

Jan. 10, 1917, for cash, from S. C. Bontell:

5 tons hay	@	$12.00
100 bu. corn	@	.90
1,000 bu. wheat	@	1.10
30 tons coal	@	4.50

Feb. 2, on account 2/10, n/30, from P. V. Stewart, $1,250.

Feb. 12, on account n/30, from I. S. Van Dorn $1,050.50.

Feb. 26, on account 2/10, n/60, from S. M. Sax, $567.40.

The purchase journal record would be made as follows:

Date		Account Classification		L. F.		
1917						
Jan.	10	S. C. Bontell				
		Terms, cash				
		5 t. hay @ $12			$60.00	
		100 bu. corn @ 90c.			90.00	
		1,000 bu. wheat @ $1.10			1,100.00	
		30 t. coal @ $4.50		√	135.00	$1,385.00
Feb.	2	P. V. Stewart	A7190	125		1,250.00
		Terms 2/10, n/30				
	12	I. S. Van Dorn	A9364	140		1,050.50
		Terms n/30				
	26	S. M. Sax	A7005	131		567.40
		Terms 2/10, n/60				
	28	Purchases, Dr. To close		10		$4,252.90

Under a system designed to show full details in the purchase journal, entry and full explanation would be made as indicated for the purchase of January 10, the first money column giving the detailed extensions, the second the total. As stated above, however, this detailed explanation is often omitted and in its stead the file number of the original invoice is written as part of the explanatory matter, which usually comprises only the terms of the purchase and this file reference. This is illustrated under February 2, 12, and 26. Of course, it is to be understood that either one method or the other is to be consistently used throughout. They are shown concurrently above only for sake of illustration.

The purchase for January 10 was for cash. Notice that instead of showing the posting, only a check mark appears in the posting index column. This is done because no account is kept with Bontell in the ledger. A similar check mark should be placed in the cash book where the

payment is shown. Stewart's account is on page 125 of the ledger where he is credited with $1,250. At the end of the month the purchase journal is footed and the summary entry, "Purchases, Dr.," is made, and posted to the debit of Purchases account on page 10 of the ledger. This one debit item in the ledger brings about the equilibrium with the individual credits posted to the various personal accounts payable. The purchase journal is ruled off and is then ready for new entries below the rulings.

Where the purchase journal is used without the full detail, as shown for entries of February 2, 12, and 26 in the illustration, there is evidently no need of the first money column for detailed extensions. Sometimes, under this method of use, the one column is used for credit purchases and the other for cash purchases in order to separate those credits which must be posted from those whose posting is omitted. Illustration of this use of the columns is given in the practice set to be worked out under Chapter XXV and following.

Departmental Analysis of Purchases

When it is desirable to separate the various classes of purchases so as to determine the profits from the different classes, particularly where the business is departmentized, a purchase journal similar to the one described might be used, having an additional money column for each class of purchases. If there were three departments, at least four money columns would be required. The entry in the first column would be for the total amount of the purchase; the other three columns would each be headed with the name of the class or department, and the portion of the total purchases belonging to each department would be extended to one of these three columns. It is evident that the totals of these columns added together, must at all times be equal

to the total of the first column. This affords a check on the accuracy of the distribution. At posting time a separate account is opened in the ledger, corresponding to each of these classes of purchases. The summary entry in a purchase journal of this kind would show as follows:

	L. F.	Total	Dept. 1	Dept. 2	Dept. 3
		$10,125.40	$4,269.80	$3,197.25	$2,658.35
Purchases, Dept. 1, Dr.	10	$4,269.80			
" " 2, Dr.	11	3,197.25			
" " 3, Dr.	12	2,658.35			

A division of purchases under separate titles would obviously call for a corresponding classification of sales.

Practice Data*

(*Assignment for Chapter XIX*)

Take a trial balance of U. R. Marchand's ledger, recording it on a piece of journal paper.

Marchand finds that he now has on hand goods valued at $3,364.39 and expense supplies of $21.40. Close the ledger, being careful to take account of the prepaid discount on the $1,200 note payable and the interest income accrued on Gibson's note.

*See Practice Data at end of Chapters XVII and XVIII.

Instructions

Close Purchases Discount direct into Profit and Loss; do not handle it in the summary to determine cost of goods sold. Usually the temporary proprietorship accounts are closed into Profit and Loss in the same order as they appear in the statement of profit and loss, viz., Sales, Cost of Goods Sold, Selling Expenses, General Administrative Expenses, and Other Income.

CHAPTER XX

THE SALES JOURNAL

Kind of Transactions Recorded Here

For the recording of sales of stock in trade, a record called the sales journal or book is used, entries in it being limited exclusively to sales of the merchandise dealt in. A sales journal of practically identical form with the purchase journal will serve this purpose, the columns being used in the same way and current entries being made in it just as in the purchase journal.

Analysis of the Sales Transaction and Method of Record

The analysis of a sales transaction shows a credit to Sales and a debit either to the customer, to Cash, or to Notes Receivable, according as the sale is "on time," for cash, or against a note given us by the customer. The current entry in the sales journal shows only the debit item, the credit to Sales account being omitted. However, the total of all these sales as indicated by the summary entry is posted to the credit side of the Sales account in the ledger. The current entries in the sales book giving the names of the customers and the amounts, are transferred to the customers' accounts in the ledger at the close of each day, in order to keep the customers' accounts up to date.

In handling the cash sales the same difficulty is met with as with cash purchases, and the treatment is the same in both cases, i.e., *all sales* are entered in the sales journal; if for cash, the item is checked in the posting index column both in the sales journal and in the cash book where the cash receipt is shown.

Summarization of the Sales Journal

At the end of the month or other posting time, the sales journal is totaled, the summary entry is made and posted, thus bringing the ledger into equilibrium by one credit to Sales account for the sum of all the debits to customers' accounts, and the closing rulings are made. The treatment is exactly similar to the corresponding work for the purchase journal, the only difference being in the summary entry, where "Sales, Cr." takes the place of "Purchases, Dr." If it is desired to keep the sales record by departments or classes of commodities, a journal with analysis columns would be used for proper distribution. When this type of sales record is used the closing summary would indicate the names of the various departmental or other sales accounts to which postings are to be made, instead of the one general account.

Goods Sold to the Owner

The treatment of goods sold to the owner of the business requires brief consideration. Where all the accounts are kept in the same ledger, no difficulty is met as to the posting of the charge, it being made to the proprietor's Personal account. Since, however, he withdraws goods at cost price, there is no element of profit in the transaction as there is in other sales. A strict analysis of the transaction would show it as a reduction of the stock of merchandise and, therefore, a credit to Purchases account instead of to Sales. Theoretically, then, such transactions should not be recorded with the regular sales, but, practically, this is the easiest method of recording them and, since they are not usually large in volume, this method does not vitiate the total sales figure as a basis for estimating percentages of profit. This matter will be discussed in detail a little later.

Practice Data*

(*Assignment for Chapter XX*)

1. Make up pro forma financial and profit and loss statements for Marchand.

2. Compare these statements with the post-closing trial balance and the Profit and Loss account in your ledger.

3. Calculate percentages of cost of sales, gross trading profit, expenses, and net profit.

Instructions

2. A post-closing trial balance is a trial balance taken after the ledger has been closed. It proves the accuracy of the closing transfer entries.

3. Use the figure of gross sales as the base for calculating these percentages. Sometimes net sales is used for this purpose; there is little uniformity in the matter.

*See Practice Data at end of Chapters XVII to XIX.

CHAPTER XXI

THE CASH JOURNALS

The Cash Book

For the recording of all transactions involving cash, two journals are used, which are known, when bound together, as the cash book. These two journals record, in one case, all receipts of cash and, in the other case, all disbursements of cash, and when bound separately are known respectively as the "Cash Receipts Journal" and the "Cash Disbursements Journal." When set up in the same binding they do not comprise distinct portions of the same book, but a page of the cash receipts journal is immediately followed by a page of the cash disbursements journal, these alternating throughout the book. This latter is the usual method of keeping the cash record. The record of cash received, being a debit to Cash, is kept on the left-hand page; and that of cash disbursed, being a credit to Cash, is kept on the right-hand page, thus forming a double page record. The debit side of the cash book may be likened as to its *suppressed* element and its postings to the purchase journal; and the credit side, to the sales journal.

Analysis and Entry of a Cash Receipt

If $100 cash is received on account from John Doe, a customer, a classified analysis of the transaction shows "Cash" debit and "John Doe" credit.

Cash	$100.00	
John Doe		$100.00

So with all receipts of cash; the "cash" element is a debit. Their record being made on a page devoted exclusively to

receipts of cash, the "Cash, Dr." element of the entry may be omitted and only the "credit" element need be shown; the very fact that the entry is made on the debit page of the cash book is sufficient to indicate that the cash is a debit.

Analysis and Entry of a Cash Disbursement

If $10 is paid out for expenses of some kind, the analysis gives "Expense" debit and "Cash" credit.

Expense	$10.00	
Cash		$10.00

So with all disbursements of cash. A separate page being devoted exclusively to cash disbursements, the "Cash Cr." element of the entry may be omitted and only the debit shown. Thus, in the cash book all left-hand pages show receipts and all right-hand pages show disbursements. It is because it is unnecessary to *write* the debit element of cash received and the credit element of cash paid out, that the great saving of labor through the use of this separate cash book is secured.

Nevertheless, it must be remembered that each of the

Dr. CASH

Date	Account Classification (Credit)	Explanation	L. I.	Amount	Columns
1916					
July 1	A. Conners	Investment	10		$5,000.00
2	Sales	Cash Sales	15	$125.00	
3	Sales	"	15	150.00	
5	J. B. Jackson	On Account	25	15.00	
	Sales	Cash Sales	15	140.00	
6	Sales	"	15	175.00	605.00
					$5,605.00
July 8	Balance				$5,240.00

Cash Book (Left-hand Page)

entries on either side of the cash book is essentially a journal entry, and that the missing elements—cash debit on the left page, and cash credit on the right page—are supplied at the end of the period by the totals and are posted through the medium of the two totals to the Cash account in the ledger—if one is kept there.

Form of the Cash Journals

For the entry on either page, provision is made, just as for all journal entries, for date, account classification, explanation, ledger posting index, and money columns. As in the purchase and sales journals, usually two money columns are provided, the one for detail—a day's or week's detail—and the other for totals. A simple form is shown on pages 144 and 145.

Cash Book Taking the Place of the Cash Account

When the two pages are set up side by side, it will be noticed that this cash book record is essentially of the same nature as the Cash account in the ledger. This double-

CASH Cr.

Date	Account Classification (Debit)	Explanation	L. I.	Amount Columns	
1916					
July 1	Rent	Store Rent July	18	$50.00	
2	Stationery		20	10.00	
3	Purchases		16	250.00	
5	A. Conners	Withdrawal	10	15.00	
6	Salaries	Clerks	19	40.00	$365.00
	Balance				5,240.00
					$5,605.00

Cash Book (Right-hand Page)

page record brings together both the receipts and the deductions from receipts—cash being normally a debit account. For this reason the cash book record is itself often used as a ledger account in book form, so that there is no need of posting the cash totals to the ledger account. When this is done it is obvious that the balance of the cash must be included in the trial balance of the ledger, because, when so used, the cash book is not only a cash *journal,* but also constitutes a *ledger* account of the cash.

When, however, the totals of both cash receipts and disbursements are posted to a Cash account in the ledger, it is evident that under this method the balance used in the trial balance would be taken from the ledger account and not from the cash book, although, of course, both amounts are the same.

Whichever of these two methods is used, however, it must always be remembered that the cash book is essentially a journal and that, therefore, its analytical classification of business transactions must be transferred to their proper accounts in the ledger.

Posting the Cash Book

In posting the debit side of the cash book to the ledger, it is very important to remember that the debit element of the transaction is not shown in writing but merely indicated by the fact that the entry appears on the left-hand page of the cash book. The account name written in the "Account Classification" column is the credit element and must be posted to the credit of the corresponding account in the ledger. Similarly, on the right-hand side of the cash book, the cash credit element of the entry is suppressed and only the debit named. Accordingly, this should be posted to the debit of the ledger account named.

After the posting of the individual items has been com-

pleted, the total cash debits and the total cash credits *may* be posted to the ledger cash account as explained above, or the cash book may be kept as a combined journal record and ledger account. In this case the total cash debits and credits are not posted to the ledger, but the balance shown in the cash *journal* must be used in taking the trial balance of the ledger, because the ledger is out of balance by the amount of the unposted cash debits and credits.

As stated above, each side of the cash book is, in reality, a journal in itself—a cash receipts journal and a cash disbursements journal—and it is only because these two journals are shown side by side that the cash book takes on the appearance and may serve the purpose of a ledger cash account.

Balancing and Ruling the Cash Book

The cash book in its simple form is balanced and ruled in the same manner as a ledger account. When the balance is brought down to the new account it is usually entered in the second or "total" column, thus reserving the first or "detail" column for the daily or weekly cash receipts, and separating these items from the balance brought down from the previous period. (See the illustration on pages 144, 145.)

Where an account is to be transferred to the next page, either the current page (double page) is balanced and ruled and only the balance carried forward, or the current page is totaled and both debit and credit footings are carried forward as shown in Chapter XV for the ledger cash account. It will also be remembered that the blank lines should be closed by a diagonal ruling on either side. The cash book is closed, ruled, and transferred as of the same date and on the same line for both sides, although usually there is room for more entries on one side. This

is done in order to keep the record of the receipts of a given period and that of the disbursements in nearly exact juxtaposition, thereby facilitating a review of the cash movements for that period.

The Cash Short and Over Account

It sometimes happens that when the cash book is balanced the amount which ought to be on hand as shown by this balance, does not agree with the amount of cash on hand by actual count. The discrepancy may be due to the fact that some items of receipts or disbursements have not been entered in the cash book, or it may result from errors in making change; it may also be that petty thieving by the cash clerk is the cause of the discrepancy. If the error cannot be rectified at the time, make entry in the cash book, on whichever side necessary, of an amount sufficient to bring the cash book into agreement with the actual cash balance. The account to be debited or credited, as the case may be, will be entitled "Cash Short and Over." If the correct charge or credit is afterwards determined, the item or items should be transferred from "Cash Short and Over" to their proper accounts. Usually the Cash Short and Over account is treated as an income or expense account and closed into Profit and Loss at the close of the period. Sometimes it is treated as an asset or liability account, depending upon the nature of its contents, i.e., the amount of the discrepancy shown and its probable cause.

Analysis of Cash Receipts and Disbursements

As illustrated in the chapters on purchase and sales journals, additional money columns are often used for the purpose of analyzing the purchases and sales by departments or classes of commodities. A similar analysis of both the cash receipts and cash disbursements may aid in

segregating certain classes of cash items and will save labor in posting. Of cash receipts, two classes are usually more active than all others combined. More cash is received from cash sales and from customers on account than from any other source. Accordingly, two additional columns may be used with these headings. *All* cash receipts must be entered in the "Total," "Bank," or "Net Cash" column, as it is variously termed, and then distributed into any special columns provided. Thus all "Cash Sales" would be extended, both in the "Net Cash" and in the "Sales" column, and all receipts from customers would be entered in the "Net Cash" and in the "Accounts Receivable" column.

In the case of cash disbursements, the number of columns depends upon the degree of analysis desired. At least two additional columns are frequently found, one for creditors and one for expenses. Where cash purchases are numerous they may be segregated, or where any particular *class* of expense is of frequent occurrence it may be shown in a separate column. Where one ledger is used for customers, creditors, and general accounts, there is little gain in segregating customers and creditors except as a slight aid in posting. Where separate ledgers are used, it is important to have separate customers and creditors columns in the cash book, as will be shown later in connection with the subject of controlling accounts.

Cash Discounts Analyzed

Sales and purchase discounts are another class of transactions best handled through the cash book, although, strictly speaking, they are not cash transactions. When a customer is sold goods on account, he is usually offered two bases of settlement, depending on the length of the credit term allowed. Thus, 2% off is frequently allowed if payment is made within ten days; otherwise the full

amount of the invoice must be paid. Because the vendor does not know, at the time of entry on his books, on which basis settlement will be made, he makes the charge at the full invoiced amount. If the customer takes advantage of the discount offered, he pays less than the amount at which his account stands debited in the vendor's books, yet the vendor must credit his account for the full amount of the original charge, in order to show full cancellation of the vendor's claim against the customer. To illustrate, a customer buys $100 worth of merchandise, with 2% off if paid within ten days. On the tenth day he pays $98. The sale entry would be:

(1)	Customer	$100.00	
	Sales		$100.00

The cash entry would be:

(2)	Cash	$ 98.00	
	Customer		$ 98.00

But this does not cancel in full the $100 claim against the customer. The $2 discount, an allowance for early payment, is an expense to the business and must be charged to an expense account called "Sales Discount" and the customer be given $2 additional credit, the entry being:

(3)	Sales Discount.........	$ 2.00	
	Customer		$ 2.00

Entries (2) and (3) are usually combined in one as follows:

(4)	Cash	$ 98.00	
	Sales Discount..........	2.00	
	Customer		$100.00

in what is known as a compound entry. If entry (2), being the part involving "cash," is made in the cash book, then the additional entry (3) will have to be made elsewhere because there is no cash element in it and theoretically nothing but cash should be recorded in the cash book.

Handling Discounts in the Cash Book

This recording in two separate places of what is really one transaction has led to the introduction into the cash book of a non-cash column in order to bring the whole transaction together. The customer's payment being a receipt of cash, the record must be made on the debit side of the cash book. Reference to entry (4) shows that Sales Discount is also a "debit." Where the cash book is limited strictly to cash transactions, the cash debit record shows only the "credit" element of the entry. The use of a Sales Discount column on the debit side of the cash book for the sake of making a complete record in one place, thus introduces an extraneous element, one out of harmony with the other entries made there. In posting, great care must be exercised not to transfer Sales Discount to the credit side of its ledger account but to the *debit* side.

Illustration and Explanation of the Analytic Cash Receipts Journal

An example of a columnar cash book debit side is given (page 152) for the purpose of illustrating some points in the above discussion. It should be understood that there is little uniformity in the columnization of cash books. The needs of a particular business govern the ruling suitable in any given case. The illustration shown is, therefore, not intended to present a standard form but is given only for the purpose of illustrating the manner of analysis of the cash receipts.

DR. CASH

DATE		ACCOUNT CLASSIFICATION	EXPLANATION	L.F.	SUNDRY	CASH SALES	ACCOUNTS RECEIVABLE	SALES DISCOUNT	NET CASH
1916 July	1	A. Conners	Investment	10	5000 00				5000 00
	2	Sales		✓		346 75			346 75
	3	Sales		✓		427 40			427 40
	5	J. B. Jackson	Inv. 7/1 at 2/5	25			125 00	2 50	122 50
		Sales		✓		300 25			300 25
	6	A. S. Brown	Inv. 7/1 net	30			200 00		200 00
		Sales		✓		392 50			392 50
					5000 00	1466 90	325 00	2 50	6789 40
			Summary		5000 00	1466 90	325 00	2 50	6789 40
		Cash Dr.		4					6789 40
		Sales Discount, Dr.		20					2 50
July	8	Balance *		✓	4802 31				4802 31

*This balance is taken from the credit side of the cash record appearing on page 153.

Columnar Cash Book—Debit Side

CASH

CR.

DATE		ACCOUNT CLASSIFICATION	EXPLANATION	L.F.	SUNDRY	EXPENSE	ACCOUNTS PAYABLE	PURCHASE DISCOUNT	NET CASH
1916 July	1	Rent	Store 7/1 - 8/1	19		75 00			75 00
		Furniture & Fixtures	A.B. Jones Furniture Co	1	560 00				560 00
	2	Purchases	A. Boutell	✓	131 50				131 50
	3	License	City license fee 7/1 - 12/31	18		25 00			25 00
		C. D. Robbins	Inv. 6/28 at 2/10	40			525 60	10 51	515 09
	5	Office Expense	Stationery & postage	17		10 00			10 00
		X. Z. Snyder	Inv. 7/1 net	45			615 50		615 50
	6	Salaries	For the week 7/1 - 7/6	20		40 00			40 00
		A. Conners	Personal use	10	15 00				15 00
		Balance			706 50 4802 31	150 00	1141 10	10 51	1987 09 4802 31
			Summary		5508 81	150 00	1141 10	10 51	6789 40
		Cash Cr.		4					1987 09
		Purchase Discount Cr.		21					10 51

Columnar Cash Book—Credit Side

As shown in the illustration, all *actual cash receipts* are entered in the "Net Cash" column which, in connection with the "Sales Discount" column, comprises the total corresponding to the "Total" column of the other subsidiary journals when an analytic record is made. All items received from customers are entered in the "Accounts Receivable" column; but it is important to note that the *amount* entered in that column is not the *actual cash receipt* but *the full amount* of the original charge to the customer. Sales discount, if any, is entered in the "Sales Discount" column, and the *net* amount, the actual cash received from the customer, is the amount appearing in the "Net Cash." Cash sales are entered in the "Cash Sales" column and also in the "Net Cash." All other kinds of receipts are extended to the "Sundry" column.

In the ledger folio column, checks are placed for the individual cash sales entries, the posting usually being made from the summary in the sales journal, as explained a little later, or from the total of the "Cash Sales" column in the cash book if the other method is not employed. In the summary entry of illustration, it is assumed that a cash account is kept in the ledger, hence "Cash, Dr." is shown posted to ledger Cash account on page 4; and the total Sales Discount, also *debit,* on page 20. Of course, the itemized credits, except the cash sales, are posted to their respective accounts as indicated in the ledger folio column.

The use of the "Sundry" column for extension of the miscellaneous items makes proof of the distribution possible. The sum of "Net Cash" and "Sales Discounts"—both debit items—must equal the sum of all the other columns.

Handling Cash Sales

If all sales, both cash and "on time," are entered in the sales journal, the totals of these two classes of sales are

posted to the ledger Sales account from the summary in the sales journal. In this case there is no need of a separate "Cash Sales" column in the cash book, because such a column would simply duplicate the "Cash Sales" column in the sales journal. Needless to say, cash sales always appear in the "Net Cash" column of the cash book, because they are cash receipts, but the "Ledger Folio" would be checked.

Sometimes two sales accounts are kept in the ledger, one for cash and the other for "time" sales. Here, also, if there is a "Cash Sales" column in the sales journal, no posting of cash sales would be made from the cash book. On the other hand, if cash sales are omitted from the sales journal, then the cash book should provide for a "Cash Sales" column and the posting must be made from the total of this column in the cash book.

Illustration and Explanation of the Analytic Cash Disbursements Journal

The cash disbursements columnar record corresponding to the cash receipts shown above, would appear as on page 153.

Just as with the cash receipts, the above illustration of cash disbursements is not presented as a standardized form but merely for the purpose of showing the method of analysis which may be applied.

Postings are made or omitted on the same basis as for cash receipts. Similarly, the same considerations govern the making and posting of the summary entry. Being few in number, cash purchases are not shown in a separate column. The treatment of discounts received on purchases is exactly parallel to that of sales discount.

Since all net cash appears in "Net Cash" column on either side of the cash book, the cash balance is found by taking the difference between these two columns. The

two sides must be ruled up and closed on corresponding lines and dates.

Alternative Treatment for Cash Discounts

Sometimes another treatment in the cash book of sales and purchase discounts is met with. This treatment for sales discount is based on the fiction that the full amount of the original charge is received from the customer and that an immediate return is made to him of the amount of the discount. To use the example cited on page 150, the entries would be:

Cash	$100.00	
Customer		$100.00

showing receipt of the full invoice price and therefore full credit to the customer, and

Sales Discount...........	$ 2.00	
Cash		$ 2.00

representing the fictitious payment in cash of a discount on sales of $2. In the cash book these two entries would appear as follows:

Dr.	Cash		Cash	Cr.
	Customer	100.00	Sales Discount	2.00

This method of entering discount on sales would have the same ultimate result in the ledger as the columnar method, but the objection to it is that it makes the cash book show more money received and more paid out than was actually the case, thus making it difficult to check the cash against the bank record of deposits and checks.

Another objection is that by this method the cash book does not show in one place a full record of the transaction, since the two items are shown on opposite sides of the cash book. Moreover, these items are seldom on contiguous lines because the one side of the Cash is often considerably "ahead" of the other.

Cash discount on purchases would be handled similarly. The first method shown, requiring special columns on either side of the cash book, is the approved method.

Problems

(Assignment for Chapter XXI)

1. For the month of January, 1917, the following purchases were made, the figures at left margin indicating day of month.

1\. J. N. Muks Wholesale Hay and Grain Co.: 10 T alfalfa in the bale at \$9.75; 50 T timothy and clover at \$10.50; 25 T native at \$12.25; 1,000 bu. wheat at 93½ c.; 2,500 bu. corn at 75c.; 3,000 bu. oats at 42½ c., terms 1/10, n/30.
Hungarian Flour Mills: 5,000 sacks white flour at \$1.40; 50 whole wheat at 90c.; 75 yellow corn meal at 55c.; terms cash.
Rocky Mountain Fuel Co.: 1 car hard lump 32.5 T at \$12.25; 1 car lignite, mine run, 25.5 T at \$2.30; 1 car Canon nut 31.7 T at \$4.50, terms 2/10, n/30.

5\. Howry Grain Co.: 5,250 bu. wheat at 95c.; 2,250 bu. corn at 67½c.; 1,500 bu. oats at 45c.; terms 2/5, n/30.

10\. Central Coal and Coke Co.: 2 cars bituminous lump, total weight, 34.8 T at \$3.75; 1 car hard nut 29.16 T at \$10.50, terms n/30.

17\. Farmers' Co-operative Elevators: 2,500 bu. oats at 39¾c.; 1,500 bu. corn at 68½c., terms cash.

24\. John Johnson: 200 T alfalfa at \$8.20; 150 T native at \$11.75. Paid by check.

29\. J. N. Muks Wholesale Hay and Grain Co.: 5,000 bu. wheat at 91¾c.; 2,125 bu. corn at 72½c.; terms n/30.

Make original entry of these transactions.

2. Sales for the month of January, 1917, were:

2. Jackson & Weaver: 5 T timothy at $13.50; 10 T Canon nut at $6; 10 bu. oats at 50c., terms cash.
T. M. Jeffery: 5 T hard lump $15.50; 50 sacks whole wheat flour $1.10; 30 cornmeal at 70c., terms n/10.
9. J. Thompson Grocery Co.: 500 buckwheat at 60c.; 750 graham at $1; 1,000 white $1.60; 100 bu. corn at 90c.
Peter McGuire: 10 bu. wheat at $1.40; 25 bu. corn at 95c.; 15 bu. screenings at 95c.; 8 T bituminous lump at $5.10.
16. Jas. T. White: 2 T alfalfa $13.50; 3 T native at $16.75; 10 T timothy at $12.50; 500 bu. corn at 91c.; 1,000 bu. wheat at $1.35, terms net cash.
S. V. Sifers: 10 T lignite, mine run at $4.25; 3 sacks whole wheat at $1.25. Received cash in payment.
23. Ole Oleson: 10 T timothy at $11.75; 15 T hard lumps coal at $15.35; 8 sacks graham flour at $1.10; 5 sacks white $1.70, received cash.
Ayres Elevator Co.: 10,000 bu. wheat at 99½c.; 500 corn at 81¾c., terms 1/5, n/30.
30. J. T. Thompson Grocery Co.: 250 cornmeal at 65c.; 275 graham at 95c.; 400 white at $1.55; 10 T timothy $12.25; terms 2/10, n/30.
T. M. Jeffrey: 10 T hard nut at $13.25; 5 white flour at $1.75. Received cash.
S. V. Sifers: 5 T Canon nut at $6.25; 10 whole wheat at $1.30; 5 cornmeal at 75c.

Enter the above in your sales journal.

3. Rule up a purchase journal with distributive heads of hay, coal, grain, flour, and enter the transactions of Problem 1, using totals only.

4. Rule up a sales journal with the same analysis columns as in Problem 3, and enter the sales given under Problem 2, using totals only.

Instructions

Problem 1. Refer to page 136 for the form and method of use of the purchase journal.

In writing coal weights, the point is sometimes used to separate tons and hundredweight; thus 32.5 T means 32 tons and 5 hundredweight.

Problem 3. Use blank paper and rule in the necessary columns. See page 138 for form.

CHAPTER XXII

THE MODERN JOURNAL

Matter Left for Record in the Journal

By the use of a cash book, a purchase, and a sales journal, three principal classes of transactions are taken out of the general journal and entered in separate books of record; the cash book, in effect, constituting two books though usually bound together, one for cash receipts and the other for cash disbursements. If the number of any other class of transactions is large enough to justify the use of a separate book of record, this should be done. The number of subsidiary journals each containing one kind of transactions may become very large, yet in practically all cases it is necessary to retain the general journal (often abbreviated simply to "the Journal"), in order to take care of such special items as are not recorded in any of the subsidiary journals.

The standard form of journal was illustrated in Chapter XVII where it was stated that a journal must provide space for date of entry, account classification, ledger folio index, debit and credit money columns, and explanation. Explanation of the form, method of use, proper observance of margins, etc., was made there and will not be repeated here.

Kinds of Transactions Recorded in the Journal

When the number of subsidiary journals used is limited to the cash book, purchase and sales journals, as is frequently the case, all items not affecting these three should be

entered in "the Journal"; i.e., transactions involving notes receivable and notes payable; adjustments with customers and creditors resulting from return of goods or claims and allowances thereon; all formal opening and closing entries. Furthermore, there is usually a number of transactions, each of a special and unusual nature, which for this reason cannot be grouped with the items of the subsidiary journals.

Journal Explanations

These various classes of transactions are of necessity entered in the Journal, and a very complete explanation should be included in their entry. In fact, all entries covering settlements and adjustments with outsiders and within the business itself are of primary importance and the explanation should be so carefully worded as to make the intent of the entry entirely and always plain and intelligible.

Closing and Posting the Journal

No particular formality attaches to the closing and posting of the ordinary standard form of journal. There is no summary entry, no totalling, and there are no rulings to be made. Ordinary care must be exercised to see that the debits and credits are correctly posted. Since the entry in the Journal is given in its complete form and no debits or credits are suppressed, as is the case in the special journals, posting is not difficult.

The Analytic Journal with Divided Columns

A more recent form of the journal has its debit and credit columns separated, the debit money column appearing at the extreme left of the page followed in consecutive order across the page by columns for date, account classification, ledger folio, and credit money amount. This kind of journal is called a divided- or split-column journal and is

ACCOUNTS PAYABLE	GENERAL	DATE 1916		ACCOUNT CLASSIFICATION	LED. FOL.	GENERAL	ACCOUNTS RECEIVABLE
	510.20	July	25	Notes Receivable	5		
				S. J. White	42		510.20
				Note at 90 days 6% in payment			
				of invoice 6/10			

Divided-Column Journal

ordinarily used for the purpose of securing control over subsidiary ledgers. When so used it is provided with additional debit and credit analysis columns on each side according to the subsidiary ledgers employed. A divided-column journal with three debit and three credit columns is shown on page 161. There is always a general money column on each side, the other columns depending on the kind of analysis required by the business.

In the above illustration an Accounts Receivable and an Accounts Payable column are provided. It is obvious that the Accounts Receivable column should usually appear on the credit side and the Accounts Payable column on the debit side; although in some cases provision is also made for an Accounts Receivable column on the debit and an Accounts Payable column on the credit. The account of S. J. White, which is paid by his note, should be credited for the amount of $510.20 and consequently the item is extended to the Accounts Receivable column.

Illustrations—Opening Entries

Illustration will be given of a few typical transactions requiring journal entry. The standard two-column journal will be used.

For the purpose of illustrating opening entries, consider the following data:

On September 30, 1916, Jack Gibson started in business, investing the following assets and liabilities: Cash $3,500; Notes Receivable $800; Merchandise $4,000; Furniture and Fixtures $450; Accounts Receivable $2,100; Accounts Payable $1,500; and Notes Payable $1,200. Enter these items on the books.

An analysis of this transaction shows that no part of it belongs to either the purchase or sales journals. The part relating to cash is entered in the cash book. However,

in order to show the complete investment in one place, the entire transaction, including the cash part, is entered in the Journal and *posted* from there, except as to the cash item. The reason for this exception is that the cash investment is also entered in the cash book and will find its way to the ledger cash account through the total cash debits at the end of the period. For this reason the cash item in the *Journal* should be checked and not posted to the cash account in the ledger.

Likewise, the investment item in the *cash book,* showing a credit of $3,500 to Gibson, should be checked and not posted to the credit of his account in the ledger, because this item forms a part of the total investment of $8,150 posted to his credit from the Journal entry.

If the student has difficulty in determining the debits and credits of entries of this kind, it may be helpful to set up the data informally first, in the form of a financial statement. Using this as a *guide,* he should then make his Journal entry, debiting all the asset items and crediting the liability and net worth items.

JOURNAL

Date	Account Classification	L. F.		
1916				
Sept. 30	Cash	√	3,500.00	
	Notes Receivable	2	800.00	
	Accounts Receivable	3	2,100.00	
	Merchandise Inventory	4	4,000.00	
	Furniture and Fixtures	6	450.00	
			10,850.00	
	Notes Payable	8		1,200.00
	Accounts Payable	8		1,500.00
	Jack Gibson, Capital	10		8,150.00
				10,850.00
	The above entry is made to bring Gibson's investment on the books.			

Dr. CASH

Date	Account Classification	Explanation	L. F.		
1916 Sept. 30	Jack Gibson, Capital	Cash investment posted from Jr.	√		3,500.00

The above entries bring the transaction completely on the books of original entry and show the ledger folios to which the various items are posted. Notice the "check" in the L. F. column in the Journal opposite "Cash" and in the cash book opposite "Jack Gibson, Capital" to prevent posting the same item twice.

For opening entries full explanation and details, where necessary, should be given in the Journal, covering lease agreements and contracts entered into when commencing business, and other similar data.

Adjusting and Closing Entries

Other typical entries to be illustrated are those made at the close of a fiscal period so as (1) to adjust the books in accordance with certain data that were not obtainable before; (2) to transfer all temporary proprietorship accounts to the summary account, Profit and Loss; and (3) to transfer the net profit, i.e., the balance of the Profit and Loss account, to the proprietor's personal account and the balance of this latter account to the proprietor's capital account.

The debits and credits of all the entries necessary to effect the record of all the data and transfers mentioned, can be determined as in the operations with ledger accounts previously shown.

The following data relate to Jack Gibson's business and

are given to illustrate the three classes mentioned above. During the year, sales amounted to $33,000; purchases $25,000; selling expenses $3,500; general administrative expenses $2,025. It was estimated that of outstanding accounts $350 were uncollectible; that furniture and fixtures had depreciated in value $45. Merchandise inventory showed $5,000 now on hand. Gibson had drawn $1,000 during the year.

The first thing necessary is to make the adjustments on account of depreciation, bad debts estimate, and present inventory. These adjustment entries are made in the Journal as follows:

1917				
Sept. 30	Depreciation	20	$45.00	
	Depreciation Reserve for Furniture and Fixtures	6		$45.00
	To bring on the books the expense due to estimated depreciation on Furniture and Fixtures.			
	Bad Debts	21	350.00	
	Reserve for Bad Debts	3		350.00
	To bring on the books the expense due to estimated loss from uncollectible accounts.			
	Purchases	15	4,000.00	
	Merchandise Inventory	4		4,000.00
	To transfer the goods on hand at the beginning of the year to Purchases.			
	Merchandise Inventory	4	5,000.00	
	Purchases	15		5,000.00
	To bring on the books the inventory of merchandise now on hand.			

The first two entries, when posted, will bring on the books valuation accounts for furniture and fixtures and accounts receivable and will set up the expense accounts,

Depreciation and Bad Debts. The third Journal entry, when posted, will transfer the goods on hand at the beginning of the year so that they can be added to the Purchases made during the year; in this connection it may be remembered that the sum of these two items, old inventory plus purchases during the year, constitutes the primary factor of "cost of goods to be accounted for." The fourth entry shows the asset Merchandise now on hand and, by its credit to Purchases, effects a subtraction from it, so that the balance of Purchases, $24,000, shows the cost of goods sold.

The books are now adjusted and ready for closing into Profit and Loss. The following Journal entries effect the closing operation:

1917				
Sept. 30	Sales	16	$33,000.00	
	Profit and Loss	25		$33,000.00
	To close.			
	Profit and Loss	25	29,920.00	
	Purchases	15		24,000.00
	Selling Expense	18		3,500.00
	General Administrative Expense	19		2,025.00
	Bad Debts	21		350.00
	Depreciation	20		45.00
	To close.			29,920.00
	Profit and Loss	25	3,080.00	
	Jack Gibson, Personal	11		3,080.00
	To transfer net profit for the year.			
	Jack Gibson, Personal	11	2,080.00	
	Jack Gibson, Capital	10		2,080.00
	To transfer the portion of the year's net gain left in the business.			

The first entry transfers the sales income to the credit of Profit and Loss. The second entry charges the Profit and Loss account with the cost of goods sold and all other expenses for the fiscal year. When the posting has been com-

pleted up to this point, the balance of the Profit and Loss account shows a net gain of $3,080, which, belonging to the proprietor, is transferred to the credit of his personal account, as shown by the third entry. He had drawn against prospective profits to the extent of $1,000, leaving $2,080 of profit remaining in the business as an addition to his permanent investment. Hence, this balance is transferred to Gibson's capital account by the fourth entry.

Objection to the Direct Ledger Method of Adjusting and Closing the Books

These adjustment and closing transactions are sometimes made direct on the face of the ledger without first entering them in the Journal. Usually this is not satisfactory because it does not show in one place a complete record of all the adjustments and closing summaries necessary at the close of a fiscal period. These are matters of sufficient concern to the business to warrant their entry in the Journal where full and complete explanations can be given. The more complex entries often needed to adjust and close the books of a business where numerous income and expense accounts are kept, follow the same general principles as those discussed above. Adjusting and closing entries are given fuller treatment in Chapters XXIX and XXX.

These two illustrations cover certain types of Journal entries which are of a more difficult character than the customary purchases, sales, and cash entries. A keen analysis is often required to formulate these entries as to their debits and credits, and the explanatory matter should be worded with sufficient care to render them intelligible even after the immediate interest in them has been lost and their recording ink has become "cold."

The other entries recorded in the Journal ought not to give the student any particular difficulty.

The books of original entry, i.e., the journals, having been explained, the attention of the student will be next directed to the sources of information on which the entries in the various journals depend. Accordingly, some of the more important papers and methods used in business will be discussed, after which further accounting principles and methods will be treated.

PROBLEMS

(*Assignment for Chapter XXII*)

1. Enter the following transactions in the cash book: Ben Salzer invested cash $5,000; sold merchandise for cash $75; paid cash for stamps $5; bought merchandise for cash $230; loaned C. W. Jenks on note at 1% a month for 15 days $250; James Goodyear is admitted as a one-third interest partner by paying $1,800; a $20 counterfeit note was discovered and we were unable to trace it; paid freight bill by check $39.03; paid light bill $5; bought coal $25; cash sales were $850; bought miscellaneous supplies for office $15; paid John Smith $50 on account and Tom Jones $175 in full of account; paid store rent $90; water tax $12; received on account from Dick Roe $125, Jno. Joe $55, Chuck Adams $32.50, J. Jack Jordan $65, and from C. W. Jenks on his note $250, interest $1.25; paid office help $12; salesman $17.50.

2. Balance and post the cash book in Problem 1 above, taking account of a cash shortage of $3.42.

3. John Short makes the following investment: cash $1,500; merchandise $2,500; furniture and fixtures $500; delivery equipment $325; rent paid in advance $50; accounts receivable $1,250; accounts payable $2,000. Make the opening journal entry.

4. Make journal entries for the following items: We remit on account to the N. Y. Mfg. Co. our 60-day note for $235.67; a customer writes in claiming goods sold him are unsatisfactory and we allow him $15 if he will keep the goods; we receive from J. W. Baker his 30-day note for $750 to apply on account; we return goods to the Rawnser Goods Co. as not being what was ordered—value $50; we receive from

T. C. Jones, a customer, to apply on account, R. S. Thomson's note for $250.

5. Inventory at the beginning was $3,962.50, at the end $3,450.75. If the sales were $6,847.69 and there was a loss on sales of $340.27, make the journal entries necessary to close.

Instructions

Problem 1. Use a double page of journal paper; write in headings as shown on pages 144, 145. Before making each entry, carefully analyze the transaction to determine its debit and credit elements. Use your own judgment as to desirable account titles. Enter the account title *first,* followed by the explanation, as in the illustration referred to above.

Problem 2. Use a sheet of blank paper for the ledger, setting up the accounts roughly in "T" form.

Problem 3. Enter the cash investment also in the cash book.

Problem 4. Give brief but adequate explanation for every entry. Be careful to maintain uniform "credit" and "explanation" margins.

Problem 5. Follow closely the Jack Gibson illustration in the text so far as it is applicable.

CHAPTER XXIII

BUSINESS PAPERS

Definition

Because of the impracticability of each person's recording on the books the transactions which take place through him, upon completing a transaction he makes a memorandum of it and hands this memorandum to the bookkeeper who uses it as the basis for the formal record on the books of account. Thus, for cash received the duplicate cash receipt may be retained by the cash clerk and turned over as a memorandum to the bookkeeper; for cash disbursed a receipt may be demanded from the person to whom the payment is made, this receipt becoming the basis for formal entry on the books. These memoranda of business transactions are called "business papers"; they comprise all of the more or less formal and informal documents which constitute the first-hand evidence of most transactions. Among the most common business papers may be mentioned: the goods invoice for purchases or sales; negotiable paper, including the check, note, draft, money-order, and warehouse receipt; the statement and account sales; the shipping order and bill of lading; the bill of sale; the lease agreement; and contracts of all sorts. A few of those most frequently used will be explained.

The Invoice

When a merchant sells goods to a customer he writes out an itemized "bill" which is sent along with the goods. This bill is called an invoice both from the seller's and customer's viewpoint. It is an itemized statement of goods

bought or sold, and should contain the place and date of sale, the names of vendor and vendee, the quantities, kinds, and prices of the goods, the terms of sale, and may contain additional items such as manner of shipment, etc.

Handling the Purchase Invoice

When goods are bought the purchase invoice received should be verified or audited. The method of audit depends upon the organization of the business. In a small business, if the invoice is received ahead of the goods purchased, it is usually held till their arrival and then checked against them as to quantities, quality, and price. The extensions and total are verified and entry made in the purchase journal, using the audited invoice as a basis. The invoice should then be placed in a temporary file till paid, after which it is usually filed under the vendor's name and held for future reference. The check in payment for the invoice is later returned by the bank, and this cancelled check is frequently attached to the invoice for which it was issued. At any rate the paid invoice should bear on its face a notation to show the payment.

In a larger business where purchase orders are made out in manifold, one copy for the purchasing department, one for the receiving room, one for the auditing department, and the original sent to the vendor, the procedure of auditing is more complex. The copy furnished the receiving room is usually left blank as to quantities, and sometimes the items indicating the kind of goods ordered are also omitted from this copy. When the goods are received, quantities and kinds are filled in by the receiving department, and the copy is sent to the auditing department where it is checked against the auditor's copy of the original order and the purchase invoice from the vendor. If found correct as to quantity, kinds of goods, extensions, and additions, the

invoice becomes the basis for entry in the purchase record—journal or voucher register as the case may be—and then follows the customary routine as to filing, remaining in a temporary file as long as it is unpaid. Upon payment it is placed in a permanent file by the name of the vendor, by invoice number, or according to whatever system may be in use.

Handling the Sales Invoice

Practically all systems of handling sales require that at the time of the sale some record or memo of the transaction be made. In retail establishments the use by each salesman of a book of sales tickets with provision for duplicate or triplicate impression is very general, whether the sale be cash or charge. The cash and charge tickets are usually put up in separate books and a different color of paper is used for each. At the close of the day the total cash tickets are checked against the cash received from cash sales, and the total charge tickets give a controlling figure for charges to customers. The total of the cash tickets plus that of the charge tickets gives the total credit to Sales. These sales tickets are usually entered on a daily sales sheet provided with distributive columns for analysis according to departments or kinds of commodities. A recapitulation giving the totals of each of these columns is made and posted to the ledger, while the customers ledger accounts may receive their charges direct from the sales ticket. This recapitulation really constitutes the sales journal record, as is explained in Chapter XXXIX.

Where the number of charge accounts is not large a folder system is sometimes used. Each charge sales ticket is placed in the folder which takes the place of that customer's account, thus avoiding the necessity of making a formal entry on the ledger. When the customer pays this

bill, the sales ticket is so marked and either left in the folder or transferred to a permanent file. The successful operation of the folder system presupposes that the customer will pay the exact amount of his bills shortly after the date of the ticket, no provision being made to care for overlapping credits. Whatever the system, the sales ticket is the original record of the transaction and therefore valuable as evidence in case of dispute. These tickets should be filed away and may be destroyed only when all danger of dispute is past.

Returned Goods Invoices

If for any reason goods purchased prove unsatisfactory and are returned, record of their return should be kept by the shipping clerk and used as a basis for securing proper credit from the vendor. The vendor usually sends a returned goods invoice, which is similar in form to the purchase invoice, but the amount of the invoice constitutes a *credit* to the purchaser instead of a charge. These credit memos, as they are termed, are always of some distinctive color, frequently red, in order to distinguish them readily from the regular invoice.

Similarly, when dissatisfied customers return goods to us, or when we make them an allowance on goods sold, a credit invoice or credit memo is sent them and the duplicate copy of this memo retained in the office becomes the basis for entering the transaction on the books.

PROBLEMS

(Assignment for Chapter XXIII)

A trial balance taken from the books of X. Z. Snyder for the year ending December 31, 1916 contained the following account balances:

X. Z. Snyder, Capital $25,910.67; X. Z. Snyder, Personal $2,045; Merchandise, $13,294.95, Dr.; Notes Receivable $597.40; Accounts Receivable $6,730.30; Accounts Payable $8,146.45; Notes Payable $2,900.75; Land $2,500; Building $5,000; Fixtures $1,210; Salesmen's Traveling Expenses $462.50; Salesmen's Salaries $1,400; Advertising $545.73; Office Salaries $700; General Expense $1,324.27; Cash $1,147.72.

Set up the accounts on your ledger allowing 6 lines for each account—after Accounts Receivable, Buildings, and Fixtures allow an additional 6 lines for the properly named valuation accounts. Take a trial balance to verify your work and record it on a piece of journal paper.

Close the ledger, taking into account the following items:

Allow 1% depreciation on buildings.

Fixtures are valued at $1,090; merchandise at $21,962.40.

Accrued general expense is $124.92; bad debts are estimated at $225.

Instructions

Set up Depreciation and Bad Debts accounts and make the inventory, appraisal, and accrued expense entries before closing into Profit and Loss.

Make the adjusting and closing entries direct on the face of the ledger.

Take a post-closing trial balance.

CHAPTER XXIV

BUSINESS PAPERS (Continued)

Use of the Note Receivable

The purpose of all sales is the ultimate conversion of stock in trade into cash to provide for the payment of services and for the purchase of commodities for future sale. This conversion of stock in trade into money may be immediate, as when goods are sold for cash, or deferred, as when goods are sold on account. In this last case the conversion is indirect, because the charge against the customer must be collected before conversion is complete.

Frequently the "note receivable" acts as an intermediate step in the process of converting stock in trade into cash. It is an instrument in which the customer formally promises to pay his debt at a fixed time in the future. The kind of claim represented by a note receivable is, legally, different from the open account claim; generally speaking, a note is considered a *better* claim than an open account. This is because the note implies a prima facie acknowledgment of the correctness of the original charge, and in event of suit relieves the holder from proving the original items of the claim.

Accordingly, when we receive a promissory note from a customer, our open account claim against him ceases to exist and a different kind of claim evidenced by his promissory note is acquired. Therefore, the open account is credited, to show cancellation of the original charge, and Notes Receivable is debited to show the new claim. It may be well to remark here that the same instrument which to us is a *note receivable* is a *note payable* to the customer.

In some cases, it is the policy of a business to encourage the receipt of notes from customers. In such cases it is often advantageous, particularly for the credit information shown, to set up the note transactions with each customer under individual names, e.g., "John Doe, Notes Receivable." Such a title would plainly indicate the nature of the items listed under it; viz., claims against John Doe, witnessed by his promissory notes.

However, the number of notes received from all customers together is usually comparatively small, and for this reason all these notes are in most cases brought together under one class title—Notes Receivable.

Negotiable Instruments—Their Use and Requisites

Notes receivable belong to a class of business papers termed negotiable instruments. The important service rendered by them lies in the fact that in many ways and for many purposes they *take the place of money.* The negotiable instrument, usually of small size but often representing a large sum of money, is used in the commerce of the world as a *medium of exchange,* thereby eliminating to a very large extent the use of heavy, bulky, and valuable coin.

The essential character of negotiable instruments can best be explained by summarizing their main requisites, as follows:

1. The instrument must be in writing and signed by the maker or drawer.
2. It must contain an unconditional promise or order to pay a fixed sum of money—and the payment must be made in legal tender.
3. It must be payable on demand or at a time which is either fixed or can be determined.
4. It must be payable to bearer or to order.

Negotiable Instruments—Kinds and Definitions

Any formal or informal document possessing these essentials is a negotiable instrument. Examples are: promissory notes, notes receivable and notes payable, drafts, checks, money orders and warehouse receipts.

A promissory note may be defined as an unconditional promise to pay a specified sum of money at a certain time. It usually has a form similar to the following:

$500.00 Jacksonville, Fla., *Sept. 9, 1916.*
Sixty days........................after date....*I*....promise to pay to
the order of *Henry Smith*..
Five Hundred and no/100....................................Dollars
At *the First National Bank of Jacksonville, Fla.*
For value received *with interest at 6% per annum.*
No. *35.* Due *Nov. 8, 1916.* *John Johnson*

The Draft

A draft is a written order by one party on a second party to pay to a third party the amount of money named. To be negotiable, it must be so drawn as to meet the requirements of negotiability named above. A draft may have a form similar to the following:

$125.75 Hoboken, N. J., *Oct. 5, 1916.*
Sixty days after sight.......................................pay to the
order of......*James Stanley Jackson and Company*..................
One Hundred Twenty-five and 75/100........................Dollars
Value received and charge to the account of
To *George S. Perkins* }
No. *93.* *Providence, R. I.* } *Bert V. Robbins*

It will be noticed that there are three parties to a draft —the drawer, the drawee, and the payee. The drawer is the person who draws the draft and whose signature appears at the lower right-hand corner of the draft. The drawee is the person on whom the draft is drawn, George S. Perkins,

above. He is sometimes called the payer. The payee is the person who is to receive the payment ordered, James Stanley Jackson & Co. To understand the use of the draft as an instrument of business, suppose the following relations exist between the three parties named above:

1. George S. Perkins bought goods from Bert V. Robbins on account for $175.
2. Robbins bought goods from James Stanley Jackson & Company to the amount of $125.75 on account.

The problem will be discussed from the standpoint of Bert V. Robbins. From the above data it is clear that Robbins has a claim against Perkins for $175 and owes $125.75 to Jackson & Co. Instead of collecting the claim against the former and paying his debt to the latter, he writes out a draft for $125.75 on Perkins, with Jackson & Co. as payee, thereby requesting (or ordering) Perkins to pay $125.75 to Jackson & Co. This draft he sends to Jackson & Co. and they present it through their bankers to Perkins. Under ordinary circumstances Perkins acknowledges the correctness of the draft and writes his acceptance *on the face of it,* thereby promising to pay the amount when due. Acceptances are usually worded in the following manner:

Accepted, Oct. 6, 1916
Payable at First National Bank
of Providence
GEORGE S. PERKINS

It should be said that the three-party draft is not usually made use of without the previously obtained consent of the drawee.

The Accepted Draft

When so accepted, the draft becomes, to all intents and purposes, an ordinary promissory note—Perkins' promise to pay Jackson & Co. $125.75. Until the draft is accepted by Perkins, it simply constitutes a request from Robbins to Perkins to pay the amount named and the draft as such does not bind Perkins in any way. Hence, no entry is made on the books of account of any of the three parties until acceptance.

Illustrative Entries

Upon acceptance by Perkins, the following entries are made:

1. On the books of Jackson & Co., the payee:

Notes Receivable....................................	$125.75	
Bert V. Robbins................................		$125.75
Robbins' draft on G. S. Perkins, accepted by Perkins, payable December 5.		

Perkins' acceptance, in possession of Jackson & Co., constitutes a claim against Perkins, and Jackson & Co. therefore debit Notes Receivable. They credit Robbins because this draft was sent to them by Robbins in payment of Jackson's open claim against Robbins for $125.75.

2. On the books of Perkins, the drawee:

Bert V. Robbins......................................	$125.75	
Notes Payable................................		$125.75
Accepted Robbins' draft at 60 days sight, favor of J. S. Jackson & Co.		

This entry cancels Perkins' liability on open account to Robbins, and shows as a substitution therefor the amount of his acceptance in favor of Jackson & Co. at Robbins' request:

3. On the books of Robbins, the drawer:

James Stanley Jackson & Co.	$125.75	
George S. Perkins		$125.75
To record the cancellation of our liability to Jackson & Co. on open account, and to credit Perkins with his acceptance of our draft on him at 60 days sight.		

From the point of view of Bert V. Robbins the acceptance by Perkins means two things: (1) the cancellation of a part of Robbins' claim against Perkins, and for this reason Robbins credits Perkins with $125.75; (2) the cancellation of Robbins' debt to Jackson & Co., hence Jackson & Co. is debited on Robbins' books for $125.75.

It is important to note here that in case Perkins should fail to pay the note at maturity, Robbins will become liable to Jackson & Co. Robbins may therefore be considered the first indorser of the accepted draft. The discussion of the manner of booking Robbins' liability contingent upon Perkins' failure to pay is deferred to Chapter XXXVIII.

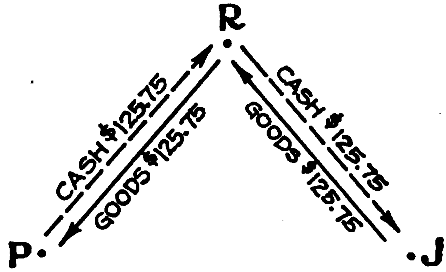
Entries After Payment of the Draft

Upon payment by Perkins, the following entries are made:

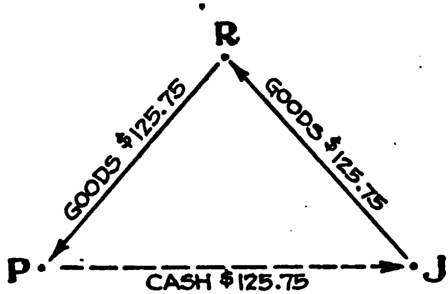
1. On Perkins' books, a debit to Notes Payable and a credit to Cash.
2. On Jackson & Co.'s books, a debit to Cash and a credit to Notes Receivable.

The following two diagrams may further illustrate the utility of the draft as an instrument of trade.

1. Showing the settlement of the several claims in *cash*—in case Robbins had collected $125.75 from Perkins and had paid $125.75 to Jackson & Co., the payments being made independently in each case:



2. Showing a settlement by draft—a clearing house method:



Classification of Drafts

There are several kinds of drafts. As to date of payment drafts are sight or time. A draft drawn "at sight" is a request on the drawee to pay at sight, i.e., immediately upon presentation to him. The use of the sight draft in making collections is quite common. The delinquent customer is drawn on at sight and collection attempted through the bank. The method is oftentimes effective because refusal to pay may reflect on the customer's credit with his own bank. Usually no formal book entry is made of such drafts until paid. A draft drawn say "at 60 days (or 30 days) sight" is a request to pay 60 (or 30) days after presentation. Hence, the dating of the acceptance of such a draft is of prime importance.

One drawn "60 (or other number) days after *date*" is called a time draft and is payable 60 days from the date of the instrument—not as in the first case, 60 days after presentation or acceptance. It is not necessary, although customary, to present time drafts for acceptance.

Drafts may be "commercial" or "bank" according as the drawee is a merchant or a bank, respectively. B. V. Robbins' draft on Perkins shown above is a merchant's draft. A bank draft is a request by one bank on a correspondent bank to pay a given amount of money to a named payee. A customary method of remitting money is the purchase and remittance of bank drafts. Banks usually charge a fraction of a per cent for issuing a bank draft. To illustrate its use take the following situation:

L. W. Roberts of Denver owes Field & Co. of Chicago $210 on account. Roberts goes to his Denver banker and buys a bank draft which may read as follows:

FIRST NATIONAL BANK No. *37849*
Denver, Colo., *Aug. 16, 1916.*
Pay to the order of *L. W. Roberts*............................*$210.00*
Two Hundred Ten and no/100................................Dollars
To *Second National Bank,* *F. G. Moffit,*
Chicago, Ill. Cashier

Before sending this draft to Field & Co., Roberts indorses it in favor of Field & Co., who upon its receipt deposit it with their own bank and through it secure its collection from the Second National Bank. Roberts paid his bank $210, plus exchange, for the draft.

Drafts may be foreign or domestic. They are domestic when the parties thereto live within the same state or country; if otherwise, they are foreign. According to the present usage, the term draft is used whenever the parties concerned live within the United States, although they may reside in

different states, and the term "bill of exchange" is applied to all such instruments where some of the parties live abroad.

Checks

A check is a draft on a depository bank. It is an individual's order to his bank of deposit to pay a named or designated payee a certain sum of money. Two illustrations are given below, somewhat different in form but identical in nature. In the first, likeness of the check to a draft is very evident.

(1)

S. E. KELLAR LUMBER COMPANY No. *575*
Hoboken, N. J., *Feb. 7,* 19*16.*
Pay to the order of *H. B. Claflin & Co*........................*$525.79*
Five Hundred Twenty-five and 79/100........................Dollars
To *The First National Bank,* S. E. KELLAR LUMBER COMPANY,
Hoboken, N. J. By *S. E. Kellar, President*

(2)

No. *575* Hoboken, N. J., *Feb. 7,* 19*16.*
THE FIRST NATIONAL BANK
Pay to the order of *H. B. Claflin & Co*..............................
Five Hundred Twenty-five and 79/100........................Dollars
$525.79 S. E. KELLAR LUMBER CO.,
By *S. E. Kellar, President*

The *certified check* is usually an individual's or firm's check bearing the certification of the bank's cashier that the check is good. This certification is evidenced by writing across the face of the check these or similar words:

Good
when properly indorsed
FIRST NATIONAL BANK
F. G. MOFFIT, CASHIER

Such a certification makes the bank responsible for its payment.

A cashier's check is a bank's own check drawn on itself

in favor of a third party and signed by its cashier. As a medium of exchange it ranks higher than the check of a private person, because the risk in connection with a cashier's check is usually smaller, due to the fact that the cashier's check of a given bank is usually more generally known in a community.

Other Negotiable Instruments

Express and *postal money orders* are drafts payable at sight, drawn by one express agent on another or by one postmaster on another.

A warehouse receipt is a receipt from a warehouse, elevator, or other storage concern acknowledging the receipt of goods or property, and usually contains the contract agreements entered into by the parties, covering the conditions according to which the goods are accepted for storage. It is usually negotiable, or partially so, in that title to the property may pass with the transfer of the warehouse receipt.

Principles Governing the Writing of Commercial Paper

One fundamental rule governs the drawing of all commercial paper and that is: So draw it that forgery of any kind shall be rendered as difficult as possible. Corollaries to the rule are:

1. Leave no blank spaces, particularly where the amount is written. When the amount is perforated, with a perforated star at either side, this is not so important as would otherwise be the case.

2. Write the indorsement at the top margin. Unless this is done it is possible for others to insert some statement which might change materially the effect of the signature: e.g., the payer might later write above the signature that the check is accepted in full payment for a definite bill.

Kinds of Indorsement

An indorsement is usually for the purpose of transferring title. There are several kinds of indorsement, as follows:

1. A *blank* indorsement, which consists only of the payee's signature; this renders the instrument payable to bearer.

2. A *full indorsement,* reading as follows: "Pay to the order of ————————," giving the name of the indorsee, i.e., the person to whom the check is transferred, and followed by the signature of the indorser, who before his indorsement was the payee.

3. A *qualified* indorsement; this is either a blank or full indorsement with the words "without recourse" added to it. This kind of indorsement transfers title with no liability attaching to the transferrer in case of non-payment by the maker at maturity.

4. A *restrictive* indorsement, giving the name of the party to whom the check is transferred, the words "for collection" or "for collection and deposit" being added and followed by the signature. This indorsement does not transfer title but merely appoints the person or bank named as agent for the purpose of collection.

Problems

(Assignment for Chapter XXIV)

Using a page of journal paper, make entries for the following, journalizing the cash. Make ample explanations. Use transaction number as the date for the current month and year.

1. We accepted May 1 at 60 days the draft of Johnson & Co., Chicago, for invoice of merchandise delivered April 30, $217.90.

2. The Hamiltonian Bank notified us May 4, that a sight draft for $175 for collection, drawn by us on Haskin & Seltzer, Bridgeport, has been paid and the amount passed to our credit.
3. We have received from A. H. Neilson & Bros. credit memo for 10 bu. apples at $1.50, which we found unsalable and returned.
4. On April 24, we drew for collection through the Mechanics Bank a 90-day draft for $273.50 on A. J. Packard & Co., Kansas City. The bank has delivered to us their acceptance.
5. Remitted to Jordan & Anderson, Plymouth, Mass., a New York draft for $579.40 in payment of our acceptance of April 10 in their favor.
6. On October 29, C. H. Henry sent us a check for $96.50 to pay for a bill of merchandise bought from us September 30, for that amount. He now puts in a claim for our regular 5% discount for 30 days, which we allow, sending him a credit memo.
7. C. H. Morey presents our acceptance for $250 in favor of Jackson & Co., indorsed over to Morey and requests that same be credited to his account. We do so.
8. Cash was short $2.10.
9. Accepted August 24, Bronstein & Co.'s draft on us for $195.40 in favor of A. B. Christian & Sons, drawn at 60 days' sight.
10. A counterfeit $5 bill was found in the cash sent to the bank for deposit. We are unable to trace it.

Instructions

By "journalizing" is meant the setting up of the debit and credit elements of a transaction according to the form used in the general journal, whether the record should properly be made there or not. Frequently the term means merely to name the debit and credit elements.

CHAPTER XXV

BUSINESS METHODS

Shipping Goods—The Bill of Lading

The purchase and sale of goods usually involve dealings with the railroad. It is not the purpose of this chapter to give an extensive system or method of handling shipments, but merely to touch on a few fundamentals. The shipment of goods is evidenced always by a bill of lading. The bill of lading contains the contract provisions under which the railroad accepts freight for carriage, defining its liabilities as transportation company or warehouseman, and stating its duties and those of the shipper. Its standard content is prescribed by the Interstate Commerce Commission, although any additions to it not in conflict with the standard content are not forbidden. If he so desires, each shipper may have bills of lading printed to conform in size with his own files, instead of using those furnished by the railroad. There are two standard forms, the *straight* bill of lading which is not negotiable, and the *order* bill of lading which is negotiable. The bill of lading is always made out in triplicate, the original and the two copies being identical except as to titles and signatures. The original is signed by the shipper and the railway agent, and constitutes the shipper's receipt for the goods delivered to the railroad.

The second, called the shipping order, is signed by the shipper only. It is his order to the railroad to ship the goods, and is held by the railroad as evidence of its authority.

The third copy or memo is an exact duplicate of the original, signed by the shipper and the agent, and is held by

the shipper as a duplicate receipt. Sometimes it is forwarded with the invoice to the customer, but otherwise should be filed by the shipper with the original bill of lading. In case of claim against the railroad for loss or damage to goods in transit the original bill of lading is required as evidence and should therefore always be kept in the shipper's possession.

Freight Notice and Expense Bill

A notice called a freight notice is sent to the consignee of all incoming freight by the railroad upon arrival of the goods. A more or less formal order is given by the consignee to the teamster or drayage company to call for the freight. This order authorizes the railroad to deliver it to the teamster or drayage company. Upon its delivery, an "expense" or freight bill is sent to the consignee itemizing the freight charges due on the shipment. The freight notice and the freight bill are usually made at one impression, the heading on the one being a notice of the arrival of freight, while on the other the heading is that of an ordinary invoice or bill showing the freight charges on the designated goods. By some railroads, three copies are made at one impression, consisting of (1) the freight notice, (2) the delivery receipt, and (3) the freight bill. Copy (2) is a receipt taken from the consignee upon delivery of the goods to him.

C. O. D. Shipments

C. O. D. shipments are handled through the agency of the express company or by the bank. Express companies accept for shipment freight which is to be paid for upon delivery, agreeing to collect the amount of the invoice and remit same to the consignor less collection and remittance charges. This method of shipping sometimes gives the con-

signee the privilege of examination before acceptance. It is used with customers who are unknown to the shipper or with those whose credit is doubtful.

When the bank is made the shipper's agent to collect on delivery, a draft is drawn on the consignee and this is sent to the bank along with a special C. O. D. bill of lading, the *order* bill referred to above. This original C. O. D. bill together with the attached draft is sent by the bank to its correspondent located in the same city as the consignee. The correspondent bank presents the draft for acceptance or payment, as the case may be, to the consignee and thereupon delivers the special bill of lading to him. The shipper's order to the railroad provides that the goods are to be delivered only upon presentation by the consignee of this special bill of lading. In the use of the order bill of lading, it is customary for the original copy to show the goods consigned to the order of the shipper himself. This copy, indorsed by the shipper, and attached draft, are the documents used by the bank in making the collection.

Duties of the Traffic Department

In a large business a special department known as the traffic department is authorized to handle all shipments. Briefly, its duties are to look after all incoming freight, its receipt in good condition and its proper distribution to the several departments; to handle all outgoing freight, its proper routing so as to secure lowest tariffs and speedy delivery; and to secure adjustment of claims for damage or loss to goods in transit.

The Statement of Account

When goods are sold, an invoice or bill showing terms of sale, quantities, items, prices, and total amount of sale is sent to the customer. Periodically, frequently the last of

the month, a statement is rendered each customer whose account shows a debit balance. This statement of account is a rescript, sometimes a summary, of the customer's ledger account, i.e., it contains all charges and all credits for the period covered. If there was a balance outstanding at the beginning of the month, the current statement opens with the balance item, followed by all charges for the current period and this followed by a list of all payments and other credits; the total credits are subtracted from the total charges and the balance constitutes the amount now due and owing. Sometimes a statement of account is made out in detail, giving a copy of the original invoices which evidence the several sales transactions. Statements of account are issued in many different forms, but the following illustration shows all the essentials.

Frequently the date of sending the statement is recorded in the explanation column of the ledger account, which, from a credit point of view, is a desirable practice.

MONTHLY STATEMENT OF ACCOUNT

New York, N. Y., May 31, 1917

Mr. J. P. Norton,
1031 Blvd. F, Saratoga, Va.

In account with

D. COHEN & COMPANY
Manufacturers of Ladies' Waists and Suits

May	1	Balance	$ 325.40	
	5	Mdse. per bill rendered	1,000.00	
	14	" " " "	575.60	
	27	" " " "	121.25	$2,022.25
		Cr.		
	4	Cash	$ 500.00	
	10	Mdse. ret'd, per credit memo	50.75	
	20	Note	1,000.00	1,550.75
		Balance due		$ 471.50

PRACTICE DATA

(*Assignment for Chapter XXV*)

For the set of transactions to be recorded now you will use a general journal, a sales journal, a purchase journal, a cash book, and a ledger. Four *double* pages of journal paper and three of ledger will suffice. At the top of the first page write "Journal of J. M. Butcher." Allow 130-150 lines for your Journal. The next blank *double* page use for a cash book, marking the left page at the top left-hand margin, "Dr.," and near the middle, "Cash." Similarly the right page, "Cash," and at the right hand margin, "Cr." Allow 80-100 lines for each side of the cash book. The next blank page mark "Sales Journal," allowing 70-90 lines. The next blank page mark "Purchase Journal," allowing 1 page. The last 3 pages, reserve for trial balances and statements. Number consecutively all pages in both blanks.

In the cash book use the first column on either side for items, the second column for totals and balances. *Balance and rule the cash book at the end of each week,* extending the "items" total before balancing. Enter the balance on the "Dr." side in the "Total" column and so keep each week's receipts segregated. At the bottom of a page, unless it happens to coincide with the end of the week, carry "totals" of each side forward, not the balance.

In the sales and purchase journals mark the first column "On Account" and the second "Cash" and make entries in them according as sale or purchase is "on account" or "cash." If "cash," entry must be made in the cash book also. In both places "check" the item in the ledger folio column as total sales and purchases are to be posted from their respective journals. In making summary entries at the end of the month, rule and total each column, bring the cash column total over on the next line into the "On Account" column, marking it "Cash Sales, total." Add these two and rule off marking them "Sales, Cr." and "Purchases, Dr." respectively.

Open the following accounts in your ledger beginning on the first page in the order given and allowing the number of lines to each account indicated by the numeral following each:

Notes Receivable	5	C. W. Collier	10
J. Q. Quinn	10	Meats Inventory	5
U. R. Sexton	10	Furniture & Fixtures	10
A. M. Roberts	10	Depreciation Reserve Furniture and Fixtures	5
C. D. Keefe	10	Building	5
A. E. Parsons	10	Lot No. 5, block 16	5
J. B. Mimmack	10		

Notes Payable	5	Purchases Returns	8
Marsh and Sons	10	Salesmen's Salaries	10
Armour & Co.	10	Advertising	10
Geib & Hodgson	10	Delivery Expense	5
K. and B. Packing Co.	10	Expense Supplies	15
Mortgage Payable	5	Rent	5
J. M. Butcher, Capital	10	Insurance	8
J. M. Butcher, Personal	15	Office Salaries	10
Profit and Loss	20	Sundry Expense	8
Sales	5	Cash Short and Over	7
Purchases	10	Interest and Discount	8
Freight and Delivery Inward	15	Depreciation	5

Before recording any transactions study carefully the accounts, particularly the expense accounts, which you will keep. Make your classification strictly according to them. Keep no additional accounts.

*Transactions**

March 2, 1917, J. M. Butcher purchased the White Front meat market, paying $1,940.16 therefor. The assets taken over were: a note signed by C. D. Keefe for $125, due March 11, after which it was to bear 8% interest; outstanding accounts, J. Q. Quinn $150.25; U. R. Sexton $125.15; A. M. Roberts $240.20; C. D. Keefe $35.20; A. E. Parsons $115.75; J. B. Mimmack $322.45; and C. W. Collier $30.50; stock of meats and accessories $2,190.87; furniture and fixtures $500. The liabilities assumed were: a note dated December 20, 1916 for 3 months at 6% in favor of the K. & B. Packing Co. for $580.40, the accrued interest assumed being $6.96; accounts due, Marsh & Sons $522.50; Armour & Co. $435.60, and Geib & Hodgson $349.75. Butcher deposited $500 in the City Bank as an additional investment. (Make the opening journal entry, showing the *cash* in both journal and cash book. Be sure to give full explanations.)

3. Bought for cash: fuel $22.50, sales tickets $5, account books $3.20, rent March 3 to April 2 inclusive, $100. Sales were: on account, J. Q. Quinn $10.75; cash $123.19.

4. Bought from Marsh & Sons on account $592.85. Paid freight-in $17.29. Bought for cash 1 year's insurance $24. Sales were: on account, U. R. Sexton $12.30; cash $145.80.

5. Paid Geib & Hodgson balance due them. Sales were: on account, A. M. Roberts $14.70, C. D. Keefe $9.20, A. E. Parsons $15.75, C. W. Collier $8.25; cash $157.95.

*Figures at left margin give day of month.

6. Bought from K. & B. Packing Co. on account $525.50. Returned to Marsh & Sons meats $75.20. Paid freight-in $15.26. Sales were: on account J. B. Mimmack $11.30, Quinn $12.40, Sexton $9.40; cash $161.90.
7. Received cash on account from: Quinn $50, Sexton $75, Roberts $100, Keefe $15. Paid: cashier $10, butcher $18. Cash sales were $170.29. Proprietor drew cash $15 and meat for the week $5.25.
9. Paid Armour & Co. on account $350; ice bill $5.75; advertising $10.25. Sales were: on account, Roberts $12.50, Keefe $10.40, Parsons $17.90, Mimmack $14.90.
10. Bought from Armour & Co. on account $619.70; paid $125 for cash register. Received cash on account from: Parsons $82.50, Mimmack $100.
11. Paid Marsh & Sons $475 on account. Paid freight-in $12.92. Returned meats to Armour & Co. $40.85. Sales were: on account, Collier $12.80, Quinn $15.90.

Instructions

March 9. Consider "ice" as an Expense Supplies item.
Remember to balance the cash book at the close of each week.

CHAPTER XXVI

BUSINESS METHODS (Continued)

Service of the Bank to the Community

Practically all business houses at the present time take advantage of the banking facilities to be found in every community where there is enough business transacted to justify the establishment of a bank. A bank is sometimes defined as an institution which deals in money and credit. One of its chief functions and the one on which its main income is *based* is that of acting as a place for the deposit of moneys, these deposits forming the basis for its loans and discounts. Other important functions and services are to collect drafts and checks drawn on other banks; to issue and sell its own drafts on other banks, thereby enabling its customers to make payments to out-of-town creditors; to discount commercial paper, i.e., to loan money to its patrons on approved security; and to issue a paper currency.

Opening an Account with the Bank

Because so much of the bank's business is based on the honor and integrity of its customers, a prospective depositor is usually required to present a card of introduction signed by a customer of the bank or someone else known to it. A depositor who wishes to open a checking account is asked to file a "signature" card bearing the signatures which he will use in signing checks. As considerable expense attaches to handling depositors' accounts, some banks require that the balance of the account shall never fall below a fixed minimum.

The Deposit Ticket

When an account is opened, the depositor is provided with a pass-book and check book. All deposits are made by means of deposit tickets, discount memoranda, or collection notices. The deposit ticket has a form similar to the following:

HAMILTON NATIONAL BANK
Deposited by

GOLD		
SILVER		
BILLS		
CHECKS (List separately)		

All moneys and checks deposited are listed on this ticket under the indicated classifications. The deposit is made with the receiving teller of the bank, who, after verifying the ticket, makes an entry of the amount in the depositor's

pass-book. Duplicate deposit tickets are usually kept by the depositor. It is important to note that checks must be indorsed before they are deposited, so as to make them collectible by the bank.

The Pass-Book

The pass-book is the record of the depositor's dealings with his bank and is usually kept from the depositor's viewpoint; i.e., the bank is debited with all deposits and credited with all checks presented for payment. At stated intervals, say monthly, the *total* amount of checks paid by the bank is entered in the pass-book, and the cancelled checks are then returned to the depositor. Sometimes the pass-book is kept in account form, the left page indicating deposits, and the right page payments by the bank. At the end of the period the account is *balanced* and the cancelled checks sent to the depositor. More frequently, however, the pages of the pass-book do not have debit and credit significance but constitute a continuous record. In this case, at the end of the period, the deposits are footed and the total of the checks is *subtracted* from the total deposits, thus showing the balance due the depositor.

A method coming into quite general use with many banks is to send a monthly statement of account just as trading concerns do. This statement is a rescript of the bank's ledger account kept with each depositor, showing deposits and withdrawals. When this is done, withdrawals are not entered on the pass-book, which thus serves only as a memo or receipt of the moneys deposited.

The Check Book

The check book is provided either with a stub, counter foil, or interleaf, for making a duplicate record of the check drawn. Provision is usually made in the check book for the

entry of the deposits. Sometimes each check is subtracted from the previous balance and the amount of the new balance shown. More often, total checks and total deposits are shown separately; in this way, while it is an easy matter to find the balance by subtracting the total checks from the total deposits, the actual figure does not appear and hence is not available to curious eyes.

The balance shown in the monthly statement or by the periodic balance of the pass-book is seldom the same as that shown in the depositor's check book. This is so because at any time there is a certain number of checks, issued by the depositor but not yet presented for payment to the bank. This matter, however, is treated in Chapter LII, "Accounts Current."

Securing a Loan Through the Discount of a Note

A common practice of business men in borrowing money is to discount or sell to their bank or to a broker their own promissory notes and those received from customers. When merchants discount their own notes at a bank, these notes bear only one signature, that of the merchant, and for this reason they are called "one-name" paper. If, on the other hand, a merchant receives a note from another, indorses it, and then discounts it at the bank, two signatures appear on it—those of the original maker and of the indorser. Notes of this kind are called "two-name" paper. Banks usually prefer two-name paper because, if the maker fails to pay the note at maturity, the indorser can be held, while in the case of one-name paper the bank has recourse to no one except the maker.

When a merchant makes out a promissory note of, say, $1,000, due 90 days after date, and discounts it at his bank, the usual method is that the interest, say, 6%, is deducted from the face of the note; i.e., the merchant is credited not

for the full $1,000 but only $985, and when the note matures he either pays the amount, $1,000, or his account is debited with it. The $15 is called "discount" because it is "subtracted" from the face of the note, but since this item is paid for the use of the amount loaned by the bank, it is of the same nature as interest. There is no reason, therefore, in having two separate ledger accounts, one for discount and one for interest paid. These two are usually combined under one title, "Interest and Discount" or "Interest."

Principles to Be Observed in the Calculation of Interest

In connection with interest computations it is important to observe the following points. The principles involved in each case will be best explained by making use of suitable illustrations.

1. In commercial practice, when the interest period is expressed in months, the interest for each month is one-twelfth of the annual interest, i.e., a note for $1,000 dated April 11, 1917, due "three months from date," matures July 11 and the interest at 6% would be 6% of $1,000 divided by 12 multiplied by 3, or

$$\frac{\$1{,}000 \times .06 \times 3}{12} = \$15$$

2. Were the same note worded "Ninety days from date," it would mature *July 10* instead of July 11, the number of intervening days being 19 in April, 31 in May, 30 in June, and 10 in July; total 90 days. The interest would amount to

$$\frac{\$1{,}000 \times .06 \times 90}{360} = \$15$$

3. When a note is dated March 6, 1917, and maturity is fixed in the note as of April 30, the interest period would be

55 days (25 in March and 30 in April). Usually, in computing the number of days in the interest period the day of the opening date is omitted but the day of closing date is included. In some instances the practice is to include both days.

It is important to note that it is almost a universal custom to use 360 as a denominator in all these cases, although the theoretically correct number would be 365. This is done for the reason that the use of 360 greatly facilitates the computation. The government of the United States makes an exception to this rule and counts the year as 365 days, and disregards the month as a unit base; i.e., instead of counting the month of January as 1/12 of a year, its computation would require the use of the fraction 31/365 as the multiplier. Interest on \$1,000 for, say, 12 days, by this method, would amount to

$$\frac{\$1{,}000 \times .06 \times 12}{365} = \$1.97$$

instead of

$$\frac{\$1{,}000 \times .06 \times 12}{360} = \$2$$

The incorrectness resulting from the commercial method (using 360 days as denominator) usually is comparatively small, and is fully justified by the economy of time in computation. It might be noted that under this practice the amount of annual interest is 1/72 more than under the method used by the government.

4. When paper is discounted by a bank, even though its term be given in months, the bank invariably counts the exact number of days in estimating the amount of the discount. Take a note dated June 25 with a term of 3 months and due therefore on September 25, but discounted at bank

on July 25. The term of discount, instead of being 2 months, would be for 62 days, a gain to the bank of 2 days on a 360-day basis.

Short Methods of Interest Computation

In calculating interest or discount, the so-called 12% or 6% method seems the easiest of application. Its base is taken as $1. In the 12% method the interest for a year is therefore 12 cents, for a month 1 cent, and for a day 1/3 mill. In the 6% method, the interest for a year is 6 cents, a month 1/2 cent, and a day 1/6 mill. Using these fractions with the years, months, and days as multipliers, the result is the interest on $1 for the given period. This result multiplied by the face of the note gives the required interest, assuming that the interest rate is 12% or 6%.

A variation of the above gives the following rule, somewhat easier of application. Reduce the time to days—using a 360-day year, 30-day month basis; multiply the time by the face, point off three places (i.e., treat the product as mills), and divide by 3 or 6 according as the calculation is on a 12% or 6% basis. If the basis used is 6%, but the actual rate is different, add or subtract whatever aliquot part the given rate is more or less than 6%; i.e., if the rate is 8%, add 2/6 or 1/3; if 5%, subtract 1/6; etc. The following example will illustrate.

A note for $1,000 dated June 10, 1917, for 4 months, with interest at 7%, was discounted July 30 at 8%. Find the net proceeds. The note when due will be worth $1,000 plus 4 months' interest at 7%. That becomes the basis for the discount calculation. Applying the 6% method:

	4 mo. = 120	days
Multiplied by	1,000	(face of note)
	120,000	

Marking off 3 points	120	
Take 1/6 (index for 1 day)	1/6	
	20	= Interest @ 6%
Add 1/6	3.33	
	23.33	= Interest @ 7%
Add	1,000	
Value of note on Oct. 10	1,023.33	
This amount is the basis on which the discount is to be figured.		
Multiply by the term of discount (72 days)*	72	
	2 046 66	
	71 633 1	
	73,679.76	
Marking off 3 points	73.67	
Take 1/6 (day index)	1/6	
	12.28	= Discount @ 6%
Add 2/6 or 1/3	4.09	
	16.37	= Discount @ 8%

*The 72 days are arrived at as follows:

1 day in July
31 days in August
30 " " September
10 " " October
—
72

Value of note Oct. 10	1,023.33
Less discount	16.37
	1,006.96 = Net Proceeds on July 30

Practice Data*

(Assignment for Chapter XXVI)

March 12. Bought country chickens and eggs for cash $50.22. Sales were: on account, Sexton $14.90, Roberts $18.20, Keefe $12.75, Parsons $13.45.

13. Bought from Geib & Hodgson on account $490.10. Paid freight-in $14.47; Marsh & Sons balance due them. Sales were: on account, Mimmack $19.25.

14. Paid: cashier $10, butcher $18. Cash sales for the week were $1,097.25. Proprietor drew cash $12 and meat for the week $7.50.

16. Bought from Marsh & Sons on account $605.14. Paid: freight-in $20.19, ice bill $6.25, advertising $10.25, billheads, stationery, and stamps $7.80.

17. Bought office safe $75 cash and paid freight on safe $7.22. Paid $25.40 for wrapping paper, twine, cartons, etc. Paid $3.25 for motor delivery service.

18. Cash was short $1.10. Sales were: on account, Collier $12.90, Quinn $15.25, Sexton $10.40, Roberts $13.00, Keefe $8.95, Parsons $14.80.

19. Paid $1.50 for sharpening knives and cleavers. Returned meats to Marsh & Sons $61.43. Bought from Armour & Co. on account $475.20. Paid freight-in $18.90.

20. Paid K. & B. Packing Co. note $580.40 and interest.

21. Paid: cashier $10, butchers $36. Cash sales for the week were $1,150.95. Proprietor drew cash $15 and meat for the week $5.75.

23. Paid: ice bill $4.90, advertising $12, vat and equipment for trying fats $25. Sold on account: Mimmack $12.45, Collier $16.50, Quinn $13.90.

24. Sold bones for cash $5.90. Bought from Geib & Hodgson on account $520.90. Paid freight-in $17.45.

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*See Practice Data for Chapter XXV. The figures at left margin indicate day of month.

25. Paid delivery service $2.50. Cash was short 95c.
26. Bought for cash, turkeys, chickens and eggs $75.83. Sold on account: Sexton $11.50, Roberts $16.75, Keefe $11.85, Parsons $16.20, Mimmack $17.95, Collier $13.40.
27. Returned meats to Geib & Hodgson $71.90. Cash was over $1.25.
28. Paid: cashier $10, butchers $36. Cash sales for the week were $1,175.69. Proprietor drew cash $10 and meat for the week $6.50.
30. Paid: K. & B. Packing Co. bill of March 6; Geib & Hodgson $800 on account; ice bill $5.20; advertising $12; proprietor's house milk bill $7.25. Cash was over 50c.
31. Bought of K. & B. Packing Co. on account $583.60. Paid: freight-in $11.25, light and telephone bills $12.93. Gave note at 90 days to Armour & Co. for $750 with interest at 6%. Collier paid $50 on account. Sales for the 2 days were cash $450.20. Proprietor took meat $1.10. Bought from J. S. Rogers the lot $750 and buildings $1,750 in which the meat market is located, paying $500 cash and $500 from private funds, the remainder secured by mortgage at 6%.

Instructions

March 17. Motor delivery service is for delivery of goods to customers.

March 20. Be careful to record the interest separately from the note.

March 31. Apply the $500 cash arbitrarily to lot No. 5, block 16, and handle the rest of the transaction through the Journal, giving full explanation, including the cash part of the transaction.

CHAPTER XXVII

METHODS OF POSTING

The Journal and Ledger Records Differentiated—Posting

When a correct and complete record of all business transactions has been made in the various journals, practically all the current information needed by the business has been recorded on these books. However, because this information is recorded in chronological order, it is not available for use. It requires sorting, grouping, and indexing. In order to meet this requirement the original chronological record must be transferred to other records which provide for the desired grouping. The separation of the general journal into journals for different classes of transactions such as sales, purchases, and cash, has resulted in making certain kinds of information somewhat more available, but this is not all that is desired by a business manager. Hence, all of the original record is grouped and summarized under proper account titles, so that the total results for the period of all the elements of the business may be had under review at one time. The book containing these account titles is called the ledger, and the transfer of the original record to the ledger is called posting.

Time of Posting

Where subsidiary journals are used, it is not customary to post all entries at the same time. The entries affecting personal accounts, i.e., those of customers and creditors, should be posted daily so as to keep those records up to date. Inquiries from customers as to their balances are received every day, and, in order that this information

may be given promptly and correctly, customers ledger accounts should be kept up to date in every respect. This is a matter of great importance because, if the information desired by the customer is not given promptly, or if an error is made in giving it, thus calling for correction at a later date, the customer's good-will may be lost and his trade transferred to others. For this reason personal accounts, especially those with customers, should be posted daily, and great care should be exercised in doing the work.

All other accounts may have their postings made periodically—once a week or once a month—the frequency depending upon the need of the business for the information furnished by the accounts. The flow of cash—always of importance—is shown daily by the cash book balance; the volume of sales each day can be had from the sales journal; but information as to expenses can usually be had only from the ledger after completing the weekly or monthly postings.

Methods of Posting

Knowing that errors in posting are easily made and that when made they may cause great confusion, it is important for the bookkeeper to know what kinds of errors occur most frequently, and to devise methods whereby he may avoid them as much as possible. Certain methods of posting have been found to produce a minimum of error. Some points in connection therewith will be considered here.

One of the chief errors in posting is to make entry on the wrong side of the account, i.e., to post a debit as a credit or vice versa. The use of subsidiary journals has done away with a large part of errors of this kind, yet it is advisable to keep the following points constantly in mind when posting:

1. The sales journal is a "charge" journal, i.e., the *individual* items represent debits and must therefore be posted to the debit side of the proper ledger accounts. The sales *summaries*, however, are credits and must be posted as such.

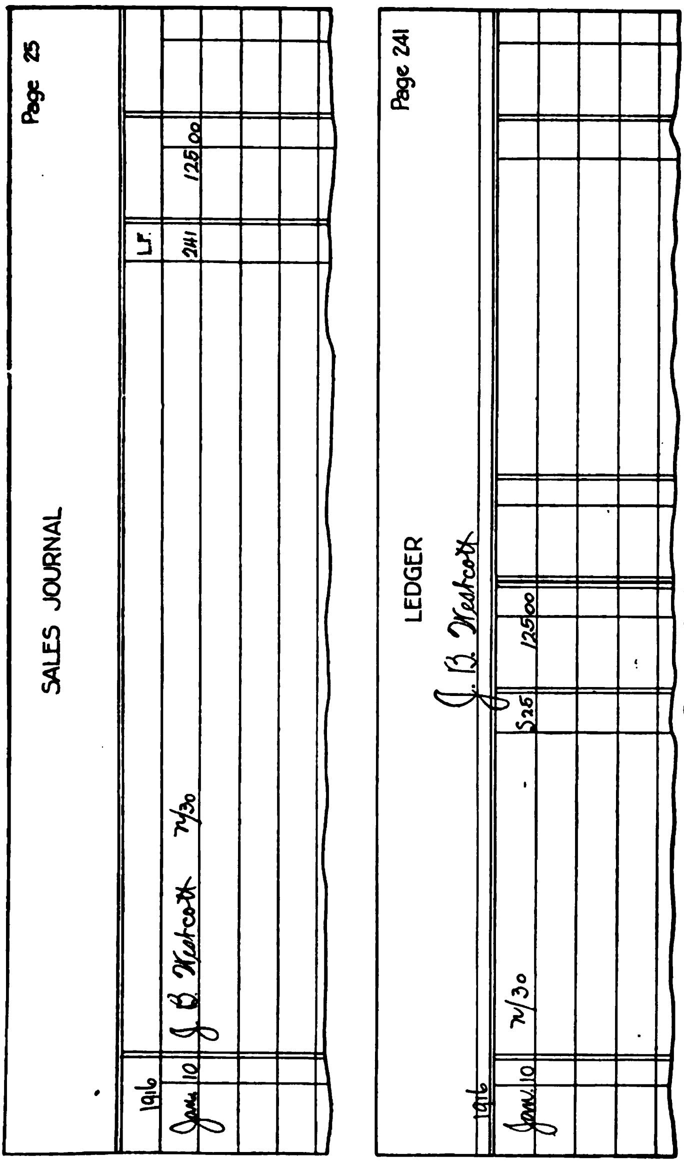
2. The purchase journal is a "credit" record and all postings, except summaries, are made to the credit side of the respective accounts.

3. In the cash receipts journal, each individual item represents a credit, as explained in a previous chapter, and each individual item in the cash disbursements journal represents a debit. Hence, postings of the individual items on the debit side of the cash book must be made to the credit side of the ledger account, and postings of items on the credit side of the cash book must be made to the debit side of the ledger accounts. The posting of the summary entries of the cash book follows the debit and credit designation made at the time of summarization. The principles here involved were fully discussed in Chapter XXI, "The Cash Journals."

4. In the Journal the debits and credits of each entry are fully expressed, i.e., neither element is suppressed. In posting from this record it is best to transfer all the debits consecutively and then all the credits. The possibility of posting a debit item as a credit is thereby greatly reduced.

Cross-Indexing the Entries

An essential part of posting, in addition to recording the date and the amount, is to cross-index every entry, i.e., to index it both in the book of original entry and in the ledger. The "folio" column in each book is used for this purpose. The index in the ledger consists of the first letter of the book of original entry followed by the page number, and the index in the book of original entry shows



Cross-Indexing in Posting

the number of the ledger page to which the item is posted. (See illustration on page 207.)

In this way the indexing in both books is complete and makes it possible without loss of time to trace the entry from the journal to the ledger and vice versa. Usually the ledger folio is entered immediately in the book of original entry after each item as it is posted. When this is done the absence of a reference number in the journal indicates that the item was omitted in posting. This check is frequently helpful in tracing errors. Some bookkeepers, however, before doing any posting, go through the book of original entry and from the account index of the ledger enter in the ledger folio column of that particular journal the pages where the accounts are found in the ledger. By this method, much time is saved in finding the account in the ledger, but a check mark should be placed after each item as soon as it is posted to indicate that it has been posted. Here the absence of the *check mark* would indicate an unposted item.

Explanatory Matter in the Ledger

In posting personal accounts it is customary to show the terms of credit in the explanation column of the account. In this way the face of the account shows the customer's manner of payment, prompt or slow, and affords a basis for his credit rating.

Notes Payable and Notes Receivable accounts in the ledger should show essential data, such as due date, interest rate, etc. However, when a separate note or bill book is used, these data are given therein and may be omitted from the account in the ledger.

With all other accounts, except sometimes the Profit and Loss account, little or no explanatory matter is carried. However, when a posting is made that is at all unusual, it is well to enter explanatory matter in the ledger. From the

business manager's point of view, the ledger is the most important book of account, and if its record can be so made as to require a minimum of reference to original books, it serves its purpose so much the better. Where possible, the Profit and Loss account should carry the names of the accounts closed into it. In fact all transfers, whether made on the face of the ledger or by journal entry, should carry the account title and the ledger folio to which, and from which, the item is transferred. It is a fundamental principle that every entry must be indexed in such a way as to render reference to it easy at any time.

PRACTICE DATA*

(Assignment for Chapter XXVII)

Balance the cash book, total and make summary entries for the sales and purchase journals.

Post completely the sales and purchase journals, then the general journal and cash book.

Take a trial balance of account balances and record it on page 13 of your journals, labelling it "Trial Balance, March 31, 1917, J. M. Butcher."

Instructions

Refer to page 136 for the form of the various journal summaries and to page 191, Practice Data, instructions to student for the method of summarizing.

Be very careful always to cross-index every posted item in both ledger and journals just as soon as the posting of that item is completed. The ledger folio columns in the journals are thus an indication as to how far the work of posting has proceeded, in case the bookkeeper is interrupted before completing the postings.

*See Practice Data for Chapters XXV and XXVI.

CHAPTER XXVIII

THE TRIAL BALANCE AND METHODS OF LOCATING ERRORS

The Trial Balance

In Chapter XV the trial balance was defined as a list of account *totals,* debit and credit, or account *balances,* debit or credit, for all the *open* accounts in the ledger. This list is set up in two columns, debit and credit, and if the work of original and secondary entry has been done correctly the totals of these two columns should be the same.

Neither method of showing the trial balance has any inherent advantage over the other. Some concerns desire the account totals to be shown in the trial balance, as that indicates to some extent the volume of business. This would be true of all accounts which had been opened during the current period. As to those carried over from a previous period little current information would be given. As a general thing, however, the status of *customers'* accounts is better indicated when both total charges and total credits are shown. Where only the balance is shown, it does not provide any basis for determining whether that balance is normal for that particular account. There is a rather close relationship between the volume of trade with a customer and the amount of his unsettled balance in judging a request for further extension of credit.

Sometimes, even the totals of accounts that *balance* are shown in the trial balance, thus giving the status of *all* accounts appearing in the ledger. Again, concerns desirous of knowing the amount owing on customers' accounts and the amount owed on creditors' claims, require *balances* of

all personal accounts and cash, but debit and credit *totals* of all other accounts. No unalterable rule can be given. The manner of showing the accounts in the trial balance is governed by the way in which the trial balance is to be used and the purpose which it is to serve. It is submitted, however, that the trial balance manifestly cannot give information of every kind desired by a manager. As personal accounts are usually handled by cancelling offsetting credits against corresponding debits and carrying only balances forward, the trial balance cannot well show at the same time both total transactions and outstanding balances. Only in small concerns could the trial balance give the information which in larger concerns would be gathered statistically and furnished in addition to the trial balance.

The tendency in modern accounting is to make the ledger record so detailed that all accounts are *currently* "uniphase," i.e., have entries on but one side, and in connection with such accounts the two methods of entering them in the trial balance are identical, because the total of the one side of the account is at the same time the balance of the account. It must be observed, that, as a matter of course, this modern tendency does not apply to personal accounts nor to adjustment and closing accounts.

Errors in the Trial Balance

The manner of entering the small pencil footings of both sides of each account and also, if it be desired, the account balances previous to taking the trial balance, was explained in an earlier chapter. This preliminary work should be done carefully so as to reduce errors to a minimum.

It is not purposed here to discuss all the kinds of errors that find their way into the accounting records. Errors are frequently made in the original analysis and classification of the transaction, which, as previously stated, result in an

entirely incorrect showing of financial condition. Such errors do not affect the balance of the books and are not detected by the trial balance. Their detection is one phase of the professional auditor's work. We have prefaced this discussion by saying that *if* the work of original and secondary entry has been done correctly, then the ledger should prove. Some points in connection with errors which often occur in posting will be treated here.

The equality of the two totals of the trial balance proves that for every debit entry on the books there has been made an equal credit, or at any rate, that the sum of all debit entries equals the sum of all credit entries; i.e., it proves only the *mathematical* correctness of the work.

It might happen that an item has been posted to the *correct side* of the ledger but has been entered in the *wrong account.* The trial balance would not detect an error of this kind. For example, John Doe's account might be debited with a charge belonging to Richard Roe, both being customers. This, of course, would make the books show wrong balances in those particular accounts, but would not cause an incorrect showing in the *total* assets. However, more serious results may accrue from an error caused by posting to the wrong account.

All transactions, according to the schedules shown earlier, bring about interrelations between increases and decreases of the three main groups of accounts, viz., assets, liabilities, and proprietorship. A transaction resulting in an increase of assets may have its credit in any of the three classes—decrease of assets, increase of liabilities, or increase of proprietorship. A credit recorded in any one of these would result in an exact offset to the debit and would, therefore, so far as that transaction was concerned, result in equal debits and credits in the trial balance, but were posting made to the wrong account the entry might be in the wrong

group and so bring about absolutely misleading and false results. This would be the case if a proprietorship account were credited, resulting in an increased profit, when the credit should have been to the liability group with a resulting increase of the liabilities—two divergent results.

Thus, while the trial balance does not detect errors in posting to the wrong account, it has great value in that its equality is considered as good evidence of the correctness of the books. This is so because errors of the kind just referred to are not of so frequent occurrence as those involving only the mathematics of the work.

Suggestions for Locating Errors

Where trial balance totals do not agree, it is certain that one or more errors have been made somewhere. The following suggestions may be useful in locating them:

1. If there is a difference of 1 in any column, i.e., .01, .10, 1.00, 10.00, etc., the error very likely results from wrong addition. Check additions of the trial balance and if the error is not located there, those of the ledger accounts must be checked as well.

2. If the difference between the two trial balance totals is an even number, divide this difference by two and look through the trial balance for an item of that amount but entered as a debit instead of a credit or vice versa. The amount of the error must be divided by two because the placing of a given item in the wrong column would result in a difference of *twice* this amount in the totals of the trial balance. If the error is not located in the trial balance, it may be necessary to look through the ledger accounts because the wrong placing may have occurred there.

In checking through the ledger for an error of this kind, some aid is afforded by the fact that all postings from *even* pages in the cash book (i.e., the cash receipts) appear on

the *credit* side of the ledger accounts, and all postings from the *odd* pages in the cash book appear on the *debit* side of the ledger accounts. If, therefore, in any of the *credit* reference columns in the ledger is seen a reference like "C 13" or "C 29" or in any of the *debit* reference columns an index like "C 40" or "C 58," it is probable that the error is due to posting to the wrong side.

3. If the mistake has not been found in this way, the trial balance should be checked against the ledger to be sure that no open accounts have been omitted. Examine all closed accounts to see that they balance.

4. Examine the posting index column of all books of *original* entry to see that no items had been omitted in posting.

5. When the totals of the trial balance are unequal, the error may lie either in the debit total or in the credit total, or both may be wrong. Even when the trial balance "proves," both totals may contain the same error. In order to determine what is the correct footing, the following method may sometimes be applied: Take the total of the previous trial balance, add to it the current totals from the several journals, and deduct the total of all accounts closed during the period. The result shows the correct footing for the present trial balance. Where the number of accounts closed during the period is large, the work entailed by this method may be prohibitive. The method is of easy application only when the trial balance is taken by means of debit and credit totals.

It may be left to the student to prove for himself why this is a correct method for determining the present trial balance total. Suffice it to state that it is based on the fundamental fact that for every credit item in any of the journals there is of necessity a debit or group of debits the total of which corresponds with the credit item.

The following table will serve to illustrate the above method:

Previous trial balance total	$12,967.30
Sales journal total for current period	8,429.60
Purchase " " " " "	5,627.40
General " " " " "	564.90
Cash receipts " " " "	2,572.60
Cash disbursements " " "	1,962.75
	$32,124.55
Closed accounts total	1,211.41
Correct trial balance total	$30,913.14

6. If the difference between trial balance totals is divisible by 9, the error may be due to a *transposition* of figures or to a *transplacement,* sometimes called a *slide.* A transposition is an interchange of figures as 96 for 69, 215 for 512, 6,274 for 4,276, etc. The first is called a simple or one-column transposition, the second a two-column, and the last a three-column transposition. One-column transpositions may also occur in numbers of three or more figures, as 172 for 712, or 3,129 for 1,329.

Transpositions

The following rules will be of help in locating errors of transposition. To determine divisibility by 9, the easiest way is to "cast out" the 9's.

(a) If the difference between the trial balance totals is divisible by 9 and consists of less than three figures, i.e., 9, 18, 27, 36, a one-column transposition may be the cause of the error. Divide this difference by 9. If the quotient is 1, the difference between the two transposed figures is 1. If the quotient is 2 or 3 or 4, the difference between the transposed figures is 2 or 3 or 4, etc. For instance:

Correct Number	Transposed Number	Difference		
54	45	9	divided by 9 =	1
87	78	9	" " 9 =	1
75	57	18	" " 9 =	2
97	79	18	" " 9 =	2
30	03	27	" " 9 =	3
85	58	27	" " 9 =	3

Thus, the figures in the last column indicate the difference between the figures of the original item.

(b) If the difference is divisible by 9 and consists of two significant figures followed by one or more naughts, the error may be caused by a *one-column* transposition between columns of a higher order. For instance:

The correct amount being..................................	6,394
and the transposed amount..................................	3,694
the difference is..................................	2,700

which divided by 9 gives 300. This indicates a transposition between figures in the "100" and "1,000" columns, the difference between these figures being 3. Reference to the example given will show this to be the case.

(c) When the difference between the trial balance totals is divisible by 9 and lies between 99 and 1,000, the error may be due to a *two-column* transposition. Here the middle figure of the error is always a 9, e.g., an error of 297 resulting from writing 512 as 215. Dividing the number (27) formed by the two outside figures of the difference by 9, the quotient (3) is the difference between the two transposed figures, i.e., the 5 and the 2. For instance:

Correct Number	Transposed Number	Difference	
514	415	99	9 divided by 9 = 1
735	537	198	18 " " 9 = 2
981	189	792	72 " " 9 = 8

Thus, the figures in the last column (1, 2, 8) indicate the difference between the two transposed figures in the correct item. Instead of dropping the middle figure of the difference and dividing by 9 as above, the entire difference figure may be divided by 99 with the same result.

(d) Similarly, when the difference is 999 or a four-figure amount with two 9's in the middle, a three-column transposition may be indicated thereby. For instance:

Correct Number	Transposed Number	Difference	
5,174	4,175	0,999	09 divided by 9 = 1
6,392	2,396	3,996	36 " " 9 = 4
7,081	1,087	5,994	54 " " 9 = 6

the figures in the last column (1, 4, 6) again indicating the difference between the transposed figures in the original.

Instead of dividing the number formed by the outside digits (9, 36, 54) by 9, we might divide the full amount of the difference (999, 3,996, 5,994) by 999; this would give the same result.

The reason for the divisibility of this difference by 999 in an error of this kind is apparent when a number is given algebraic notation instead of Arabic. The Arabic number 2,197 expressed algebraically would be 2,000 + 100 + 90 + 7. Generalizing, we may formulate any number of four figures by 1,000a + 100b + 10c + d, in which a, b, c, and d may have values from 0 to 9 inclusive.

A transposition between the thousands and units digits, the "a" and the "d," would result in the following number: 1,000d + 100b + 10c + a. The error would, therefore, be:

Original number	1,000a + 100b + 10c + d
Transposed number	a + 100b + 10c + 1,000d
Difference	999a — 999d

This error is plainly divisible by 999, and the resulting quotient (a — d) is the difference between the two transposed digits.

It may be shown similarly why 99 is a divisor of the error cited under case (c) above.

Transplacements

A transplacement or slide occurs when some or all of the digits of a number are moved one or more places to the right or left without change in the order of the figures, for instance 736 written as 73.60, as 7.36, or as 700.36. The first is called a one-column slide, the second and third two-column slides. The error caused by a one-column slide is always divisible by 9, a two-column by 99, a three-column by 999, etc. The division by 9, 99, 999, etc., disregarding decimals, always gives the figures whose transplacement has caused the error. Thus, the error caused by writing 736 as 73.60 is 662.40, which divided by 9 is 736; or 736 written as 7.36 produces an error of 728.64 which divided by 99 gives 736; or 736 written as 700.36 causes an error of 35.64 which divided by 99 gives 36, the part transplaced. The reason is similar to that given above for the transposition.

When a whole number of dollars is written as cents, the resulting error is divisible by 9 and moreover the cents *added to* the dollars gives 99 in each case. For instance in writing:

.73	instead	of	73.00	the	resulting	error	is	72.27
.58	"	"	58.00	"	"	"	"	57.42
.16	"	"	16.00	"	"	"	"	15.84

When the error in the trial balance is of this kind, the amount transplaced may be found by subtracting the cents of the error from 100. In the above examples this difference would be 100 — 27, 100 — 42, 100 — 84, or 73, 58, and 16 respectively, which are in each case the figures of the transplaced amount as seen in the example. Having determined this, the trial balance and ledger accounts should be gone over to look for a slide of the given number.

Checking the Postings

From the above discussion, the impossibility of determining, in all cases, the nature of the error is quite evident —particularly as to whether it is one caused by a transposition or a slide. Unless the kind of error is readily discernible, it is usually advisable to employ the method of checking, i.e., going over all the work of posting to determine its correctness—or other methods to be discussed in Chapter LIV. After all, careful work in making the record with legible figures and in performing additions and subtractions, proven wherever possible, more than pays for itself in the time saved hunting for errors caused by slovenly and inaccurate work.

Practice Data*

(Assignment for Chapter XXVIII)

Close the ledger taking into account the following adjustments and inventories:

Interest accrued on C. D. Keefe's note 56c.
Expense supplies inventory $9.50.
Insurance unexpired $22.
Salesmen's salaries accrued $12.
Office salaries accrued $3.33.
Advertising accrued $4.
Prepaid rent for 2 days $6.67.
Furniture and fixtures valued at $725.
Meats inventory $2,236.21.
Take a post-closing trial balance.

Instructions

As required in previous similar problems, bring on the books all of the prepaid and accrued expense and income entries and those covering inventories and appraisals before making the closing entries. It will be wise to make rough drafts of financial and profit and loss statements before closing to make sure of the correctness and accuracy of the work. The profit and loss statement will prove a convenient criterion by which to judge the accuracy of the items transferred to the Profit and Loss account.

Be sure to rule off the necessary accounts. Do not balance customers' and creditors' accounts.

*See Practice Data for Chapters XXV to XXVII.

CHAPTER XXIX

ADJUSTMENT ENTRIES AND CORRECTIONS

The Need for Adjustment Entries

In Chapter XVI it was shown that the records as they are usually kept, do not reflect the true condition of the business at any time *during* a fiscal period. For this reason, before making the financial and profit and loss summaries it is always necessary to bring onto the books a number of entries whose purpose is to "adjust" the record to make it reflect true condition. These adjustments may be made by entry direct on the face of the ledger, but it is better to run them through the journal, thus making it possible to give ample explanation. A further advantage of making the adjustment entries in the journal first is that in this way all such entries appear *in one place* in the books of account.

Inventory of Stock in Trade

One of the most important adjustment entries is the one by which the inventory of stock in trade is brought on the books. By reference to Chapter XVI, it will be seen that none of the accounts connected with merchandise, viz., purchases, sales, returns, etc., contain any definite and up-to-date information as to the value of merchandise on hand. However, the financial statement, the statement of profit and loss, and the Profit and Loss account call for this information. Therefore, before these statements are made the value of goods on hand should be determined and brought on the books of account. The process by which this is done is called "inventory taking."

Without going into the detail of outlining a system for

taking an inventory, three fundamental principles can be stated relative thereto:

1. Make sure that all goods belonging to the firm on the date of the inventory are included.
2. Make equally sure that there is no duplication of count, i.e., that no goods are counted twice.
3. See that the condition of the goods, viewed from the standpoint of salability, is indicated.

Two factors of importance enter into the determination of the inventory, viz., the quantity of the goods on hand and their value per unit. Inaccuracy in either one of these two factors may lead to a gross error in the final amount. By falsifying the count of the goods the inventory could, of course, be inflated. A usual and more elusive method, often resorted to, consists in raising the price per unit, since the addition of even a fraction of a cent per unit may have the effect of converting an actual loss into a seeming profit. Without further indication of the reason for such valuation, it is now generally required that the inventory be valued on the basis of cost. The term "cost" should include all costs, not only the purchase price, but also duties, freight, drayage, insurance during transit, etc., up to the point of placing the goods in condition ready for sale.

After the amount of the inventory has been determined, it is placed on the books. However, before this is done it is necessary that the Merchandise Inventory account be cleared of the goods on hand at the *beginning* of the period by transferring the amount to Purchases. The following journal entry will effect the transfer:

Purchases
    Merchandise Inventory
        To transfer the opening inventory to Purchases.

The posting of this entry will automatically clear the Inventory account and, by its addition to Purchases, will cause that account to show the "total goods to be accounted for." Purchases, as it now stands, is a mixed account containing both the cost of goods which have been sold during the current period and those which are still on hand as shown by the inventory just taken. Accordingly, to separate the two elements, the expense and the asset, the following journal entry is necessary:

Merchandise Inventory
Purchases
To set up the inventory of goods now on hand.

This entry posted will show in the Merchandise Inventory account the asset element, and will leave in the Purchases account the unmixed expense element. The effect of these two entries, then, is to adjust the books to true conditions so far as the merchandise is concerned.

Other Adjustment Entries

Further adjustment entries necessary at the closing date are those connected with depreciation, bad debts, prepaid and accrued expenses, prepaid and accrued income. These include such items as:

1. Depreciation of machinery, buildings, etc.
2. Losses due to uncollectible customers' accounts.
3. Prepaid expenses, as for instance, insurance paid in advance, part of which is applicable to the current period, and the balance chargeable to a later period; similarly rent and interest paid in advance; also supplies bought and paid for, but chargeable to this period only in part, the balance affecting a subsequent period.

4. Accrued expenses, chargeable to the current period but not yet paid for by the business, such as wages, salaries, and taxes.
5. Prepaid income, i.e., income received in advance, as rentals, advertising contracts, magazine, newspaper, and special edition subscriptions.
6. Accrued income, i.e., income earned but not yet received, as interest, rent, dividends.

All such items must be taken into account and entered upon the books before the final results for the period can be correctly shown.

It may be observed here that if a business manager has an intelligent insight into the development of his enterprise, and carefully watches the volume of sales, purchases, and expenses, he may be able to forecast with some degree of accuracy the *approximate* results for a given period; but only by making the actual count of stock now on hand and careful estimates of the six classes of items just mentioned can *accurate* and *dependable* results be assured.

These six classes of adjustment items will now be discussed and the manner of handling them illustrated.

Depreciation, and Loss on Doubtful Accounts

As indicated in Chapter XVI, the amount of depreciation of particular assets and the losses due to bad and doubtful accounts are carefully estimated at the close of the fiscal period. The individual depreciation items are all summarized in a *single* depreciation account—an *expense* account whose total debit is closed out to Profit and Loss. The *depreciation reserves,* however, which are credit items, are handled under *separate* account titles, and constitute the valuation account of the corresponding assets. The journal entry covering depreciation will read as follows:

Depreciation
Depreciation Reserve for Buildings
" " " Furniture and Fixtures
" " " Delivery Equipment
" " " Machinery

and that covering bad debts:

Bad Debts
Reserve for Doubtful Accounts

The Reserve for Doubtful Accounts is the valuation account of accounts receivable. For instance, assume that the debit balance of the latter is $15,900 and the credit of its valuation account is $600, the difference between these two accounts, viz., $15,300, would represent the estimated value of accounts receivable. Therefore, when the two entries above are posted, the present appraised value of those particular assets is brought on the books; i.e., out of those asset values, as shown at the beginning of the period, are taken the portions estimated to have been used up or lost through depreciation. These lost portions are set up as an expense item, leaving in the adjusted asset accounts true asset values as existent at the close of the period.

Expense Paid in Advance

When a part of the expense paid during the present period applies to the next period, this portion must be taken out of the current expenses and held over, deferred, as a charge to the expenses of next period. Taking insurance as an example, the following journal entry would effect the required adjustment:

Insurance (Deferred)
Insurance

In posting this entry, the credit part is posted first in order to take out of the excessive cost shown chargeable to this

period the portion equitably belonging to the next period. When this is done the debit *balance* of the insurance account indicates the amount to be charged to the current period and is the correct charge against the Profit and Loss for this period. After making allowance for the space needed for closing the account, the debit side of the above entry is posted, this debit becoming the first charge in the account for the next period. Note that the use of the bracketed "Deferred" is for the purpose of guiding in posting and is evidence that that portion of the entry is not to be posted until provision has been made for closing the account. After posting is completed the Insurance account would show as follows:

INSURANCE

January 2	$125.00	December 31	$200.00
April 10	250.00		
August 15	300.00		
	$675.00		
January 1	$200.00		

There remains, of course, the transfer to Profit and Loss of the current balance before the account is *closed.* This closing work is treated in the next chapter.

Accrued Expense Items

These items cover expenses which the business has incurred but not yet paid and which are properly chargeable to this period but have not yet been charged on the books. For instance, salaries earned up to the close of the period but not paid at its close constitute an additional charge to the period's operations which must be entered on the books before they will show true conditions. This amount also

constitutes a liability of the business. Accordingly, the journal entry would be:

Salaries
  Salaries (Accrued)

thus charging the Salaries account with the amount due but not paid, and bringing this amount down as a credit balance to the new account for the next period. Assuming this unpaid amount to be $72, the account after closing will show this $72 as a liability on the *closing date*. Its effect, however, during the next period will be to *reduce* the amount charged to salaries during that period, because this $72 although paid during that period had already been charged to the previous period. This credit to Salaries therefore serves two purposes, viz., that of showing the outstanding liability at the *close* of the current period and that of effecting a reduction of what would have been, without this credit, an overcharge to *next* period's salaries. For example, if the total salary paid during the next period is $600, the *balance* of $528 would indicate the amount applicable to that period, although the amount actually paid is $600.

Prepaid Income Items

So far as debit and credit is concerned, these items are handled in a manner similar to the accrued expense items. They cover income items received by the business during the present period, a part of which income belongs to the subsequent period, as for instance, rent paid in advance by a tenant. In this case the journal entry would be:

Rent Income
  Rent Income (Deferred)

the effect being to decrease the amount of rent income for

the current period and to show the portion belonging to the next period deferred to the next period's account.

Accrued Income Items

These items are handled in a manner similar to expenses paid in advance. Take the case of interest income earned but not due. The entry for adjusting it is:

Interest and Discount (Accrued)
Interest and Discount

The credit part is posted immediately, thereby showing an addition to the income already recorded as earned during the current period. The debit part is posted after the current account is adjusted and allowance made for closing it into Profit and Loss. It is then entered on the debit side of the *new* account. Assume this debit item to be $50 and the interest received during the next period to be $170. The new account will indicate a *credit balance* of $120, this being the amount actually *earned* during that period, since the previous period took credit for the $50 accrued or earned during *that* period.

Corrections

When an error has been made in any entry on the books, it should not be erased or scratched out, because by so doing suspicion may be raised as to what was covered up by the erasure. Rule out the wrong item without destroying its identity and write the correct item above it or wherever it belongs. This applies particularly to books of original entry whose use as evidence has often been destroyed because many erasures appeared in them.

Instead of making the correction as indicated above when an amount has been posted to a *wrong account*, correction may be made by first cancelling the wrong posting

through a similar entry on the *other side* of the same account, and then posting it to the correct account. Cross-reference to the two accounts must be made.

When an amount has been posted to the *wrong side of the correct account,* e.g., $100 to the credit side of John Doe's account, when it should have been posted to the debit side, the incorrect credit may be cancelled by a debit of $100, after which the original $100 should be entered on the debit side; or the cancellation and correction may be combined by entering $200 on the debit side. Better still, the incorrect posting may be ruled out and a correct posting made of the *original entry* whose wrong posting caused the error. Adequate cross-reference should be given so as to make easy the tracing of the items and to indicate exactly what was done.

All these entries are of a somewhat unusual nature and their exact purpose should be plainly indicated in the explanation columns.

According to the methods mentioned above, the various correcting entries are made directly on the face of the ledger. It is often preferable, however, first to make the required correction entries in the journal with full explanation, and then to post them to the ledger.

Problem

(Assignment for Chapter XXIX)

A trial balance taken from the books of A. P. Lindsey for the year ending December 31, 1916 showed the following account balances:

Cash $590.21; Notes Receivable $569.75; Accounts Receivable $8,275.46; Merchandise Inventory $4,975.20; Office Furniture $725.80; Store Furniture $2,490; Buildings $10,240; Land $3,000; Accounts Pay-

able \$5,460.75; Notes Payable \$2,192.67; A. P. Lindsey, Capital \$20,000.00; A. P. Lindsey, Personal \$1,701.09; Sales \$45,932.75; Sales Returns and Allowances \$2,193.60; Purchases \$30,190.40; Purchases Returns and Allowances \$2,970.80; In-Freight and Drayage \$3,841.39; Salesmen's Salaries \$2,390.67; Advertising \$1,140.75; Insurance \$316; Office Salaries \$1,200; Light and Fuel \$750; Office Supplies \$250.30; General Expense \$1,590.55; Interest and Discount \$125.80 (Dr.).

Set up the accounts on your ledger, allowing 6 lines for each account. Make provision for valuation accounts. Take a trial balance to verify your work. (Record the trial balance in the back of the Journal.)

Draw up statements of financial condition and profit and loss, taking into account the following items:

Allow for depreciation: 1% on buildings, 10% on store and office furniture.
Create a 3% reserve for doubtful accounts.
Unexpired insurance amounts to \$75.40.
Salesmen's salaries accrued \$100.
Merchandise now on hand \$5,190.34.

Instructions

A double sheet of journal paper or of 3-column paper will suffice for trial balance and statements.

CHAPTER XXX

CLOSING THE BOOKS—SUMMARY STATEMENTS

Purpose of Summarizing

After posting all adjusting entries to the ledger, the books reflect the true condition as of the date of these entries. However, at this stage the information contained in the ledger is usually scattered over a large number of accounts, and in order that a concise view may be obtained of the main results of the business it is necessary to summarize this information. The Profit and Loss account is the means by which the proprietorship accounts are summarized and the net results as to profits or losses indicated on the books of account.

In this connection it will be remembered that the adjusting entries have already effected a separation of the elements of all mixed accounts, so that all temporary proprietorship items—expenses and income—applicable to the current period are now separately shown. The *transfer* of these proprietorship items to the Profit and Loss account constitutes the work of closing.

Method of Closing

However, instead of transferring all these accounts directly to Profit and Loss, frequently *partial* summarization is made elsewhere. For example, instead of transferring In Freight and Delivery, Purchases Returns and Purchases Rebates and Allowances direct to the Profit and Loss ac-

count, they are first closed into the Purchases account. The balance of this account will then show the *cost of goods sold.* Likewise, Sales Returns and Sales Rebates and Allowances are closed into the Sales account which will now show by its balance the net sales.

The debit balance of the Purchases account, cost of goods sold, is then transferred to the Profit and Loss account, and similarly, the credit balance of the Sales account representing net sales is transferred to Profit and Loss as a credit item. The Profit and Loss thus shows on the credit side net sales and on the debit cost of goods sold, the difference being the gross profit on sales. If it is desired to show on the face of the account, the actual figure of gross profit, the Profit and Loss account may be balanced at this stage, and the balance brought down will show the figure of gross profit for the period.

After the net sales and cost of goods sold are transferred to the Profit and Loss account, all expenses directly connected with sales, such as Salesmen's Salaries, Salesmen's Traveling Expenses, Advertising, Delivery Expense, Depreciation on Delivery Equipment, on Store Furniture and Fixtures, and similar items, are closed into the Profit and Loss account.

The groups of accounts closed next are those covering "General Administrative Expenses" and "Other Income." It will be noticed that the *order* of closing follows the order in which the same items appear in the profit and loss statement.

The Profit and Loss account now shows on the credit side all the items of income, and on the debit side all costs and expenses applicable to the current period. Its balance then gives the net profit (or loss) covering the period's transactions.

Throughout the period, as the profit was accruing, the

proprietor has been drawing against it for personal use as shown in his personal account. In order to show the amount of profit remaining in the business, the balance of the Profit and Loss account is transferred to the personal account, the balance of which then gives this amount of undrawn profit. The balance of the personal account is closed into the capital account, the credit balance of which then represents the net worth of the business at the end of this period and at the commencement of the next.

Effect of Closing the Ledger

This completes the work of closing the ledger. All open balances now shown on the ledger constitute either assets, liabilities, or vested proprietorship. After the closing process is complete, all temporary proprietorship records for the *current* period have been closed out. Having served their purpose of providing current information for the period, these accounts have been cleared of their current record and prepared to receive the record of the next period. The business cycle for this particular business has been completed and its correct history recorded.

Profit and Loss Not an Account for Current Entry

It should be kept clearly in mind that the process of closing the books is merely a method, a device, by which the transactions for the year are *summarized* and the net result determined. This net result, whether a profit or a loss, belongs to the proprietor and must ultimately be shown in his account. It is, therefore, manifest that the Profit and Loss account is *only* a summary account and should never be used for current entry. It is the medium by which the *temporary* proprietorship accounts are summarized and through which the net result is cleared into some *vested* proprietorship account or accounts.

Making the Closing Entries

The two methods employed for bringing the closing transactions on the books are the same as for the adjusting entries, i.e., by entry direct on the ledger or by journal entry first and then posted to the ledger. The second method has two important advantages: first, by entering them in the journal it is possible to add such complete explanation as may be required in each case, while it is practically impossible to do so in the ledger; second, by entering all closing entries in the journal, they are shown together *in one place*. The adjustment and closing of the books constitute a most important and vital process. Consequently, the method making possible ample explanation and a complete record in one place is the best.

Closing the Books Illustrated

In order to give full and complete illustration of the process of adjusting and closing the books through the journal, a trial balance of M. J. Duncan's ledger is shown, together with the data for adjustments. The illustrations given include the adjusting and closing entries, the ledger Profit and Loss account, the profit and loss statement, and the financial statement. Arbitrary folio numbers are used throughout.

TRIAL BALANCE, DECEMBER 31, 1916

	Cash	$1,250.19	
3	Notes Receivable	1,490.00	
4	Accounts Receivable	3,675.40	
10	Merchandise Inventory	5,187.51	
10	Delivery Equipment	560.75	
11	Furniture and Fixtures	432.50	
14	Notes Payable		$1,000.00
15	Accounts Payable		1,620.15

TRIAL BALANCE—*Continued*

20	M. J. Duncan, Capital		10,000.00
21	M. J. Duncan, Personal	731.01	
35	Sales		19,478.90
36	Sales Returns and Allowances	467.70	
38	Purchases	16,580.20	
39	Purchases Returns and Allowances		1,590.10
40	In Freight and Delivery	279.80	
45	Clerk's Salary	1,140.50	
46	Delivery Expense	440.90	
46	Insurance	51.40	
47	Office Salary	695.00	
47	Light and Heat	40.70	
48	Office Supplies	125.60	
49	General Expense	590.17	
51	Interest and Discount		50.18
		$33,739.33	$33,739.33

ADJUSTMENT DATA, DECEMBER 31, 1916

Merchandise Inventory	$6,720.81
Unexpired Insurance	15.20
Office Supplies Inventory	30.19
Office Salary Accrued	25.00
Interest Receivable	10.41

Depreciation of Delivery Equipment estimated at 16 2/3%.
Depreciation of Furniture and Fixtures estimated at 10%.
Bad Debts estimated at 2% of the outstanding Accounts Receivable.

JOURNAL OF M. J. DUNCAN

1916				
Dec. 31	Purchases	38	$5,187.51	
	Merchandise Inventory	10		$5,187.51
	To transfer initial inventory.			
	Merchandise Inventory	10	6,720.81	
	Purchases	38		6,720.81
	To bring the final inventory onto the books.			

JOURNAL OF M. J. DUNCAN—*Continued*

Insurance (Deferred)	46	15.20	
Insurance	46		15.20
To defer the unexpired insurance to next year.			
Office Supplies (Deferred)	48	30.19	
Office Supplies	48		30.19
To defer till next year the cost of supplies now on hand.			
Office Salary	47	25.00	
Office Salary (Accrued)	47		25.00
To charge current period with unpaid salary.			
Interest and Discount (Accrued)	51	10.41	
Interest and Discount	51		10.41
To credit current period with interest earned but not yet due.			
Depreciation	53	136.71	
Depreciation Reserve Delivery Equipment	10		93.46
Depreciation Reserve Furniture and Fixtures	11		43.25
To show the appraisals of the above assets and charge current period with expense of depreciation.			
Bad Debts	53	73.51	
Reserve for Doubtful Accounts	4		73.51
To show estimated loss from uncollectible accounts.			
Sales	35	467.70	
Sales Returns and Allowances	36		467.70
To show net sales.			
Purchases	38	279.80	
In Freight and Delivery	40		279.80
To show full cost of purchases.			
Purchases Returns and Allowances	39	1,590.10	
Purchases	38		1,590.10
To show net purchases and cost of goods sold.			
Sales	35	19,011.20	
Profit and Loss	76		19,011.20
To close.			

JOURNAL OF M. J. DUNCAN—*Continued*

Profit and Loss....................	76	13,736.60	
Purchases	38		13,736.60
To close.			
Profit and Loss....................	76	3,274.10	
Clerk's Salary....................	45		1,140.50
Delivery Expense..............	46		440.90
Depreciation	53		136.71
Office Salary....................	47		720.00
Light and Heat................	47		40.70
Office Supplies................	48		95.41
General Expense..............	49		590.17
Insurance	46		36.20
Bad Debts....................	53		73.51
To close.			
Interest and Discount..............	51	60.59	
Profit and Loss................	76		60.59
To close.			
Profit and Loss....................	76	2,061.09	
M. J. Duncan, Personal.........	21		2,061.09
To transfer net profit.			
M. J. Duncan, Personal............	21	1,330.08	
M. J. Duncan, Capital..........	20		1,330.08
To close Personal account.			

The Profit and Loss Account

The first eight journal entries shown are the adjusting entries, the others are closing entries. It will be seen that frequent use is made of compound journal entries; thus a number of proprietorship accounts are closed into Profit and Loss by means of one entry. In posting the profit and loss element of such entries, it is customary, in small concerns, not to post the single total, but the individual items shown by the contra side of the journal entry. In this way the Profit and Loss account in the ledger will show the individual accounts closed into it, with the corresponding amounts charged or credited to Profit and Loss. This Profit and Loss account will then appear as follows:

PROFIT AND LOSS ACCOUNT

1916				1916			
Dec. 31	Purchases	J46	$13,736.60	Dec. 31	Sales	J46	$19,011.20
	Clerk's Salary	"	1,140.50		Interest and Discount	"	60.59
	Delivery Expense	"	440.90				
	Depreciation	"	136.71				
	Office Salary	"	720.00				
	Light and Heat	"	40.70				
	Office Supplies	"	95.41				
	General Expense	"	590.17				
	Insurance	"	36.20				
	Bad Debts	"	73.51				
	M. J. Duncan, Personal	"	2,061.09				
			$19,071.79				$19,071.79

Need for the Summary Statements

The two periodic statements—the statement of financial condition and profit and loss—do not form an integral part of the books of account. They are drawn up periodically and submitted to the proprietor, because the latter does not always have ready access to the books of account and usually lacks sufficient knowledge of accounting to interpret correctly the information shown by the journal and ledger. The periodic statements are intended to show the results of the year in a concise, non-technical form, so that a proprietor, even though not versed in the science of accounts, can readily understand them.

The Financial Statement

The statement of financial condition may be arranged in either of two forms. The first form illustrated follows the principles already laid down and is usually called the "Financial Statement." Reference to Chapter IV will give explanation of the essential points to be considered in drawing up this statement. The second form is usually called the "Balance Sheet." It shows financial condition by means of the account form, the subtraction of the liabilities from the assets being indicated by their respective positions in the account. It will be noticed, however, that this method of showing the subtractions is not strictly adhered to, some deductions being actually performed, as for instance in the case of Bad Debts which is subtracted from Accounts Receivable. This is done in order to render the statement more intelligible. The same principles govern the arrangement of the items and groups of items as in the first form, viz., degree of liquidity for the assets and a similar arrangement for the liabilities.

Form (1), sometimes called the report or non-technical form, is perhaps more in favor in the United States because

it seems more readily intelligible to the man unversed in technical account-keeping. Form (2) may be called the account or technical form and is the form used generally in statements drawn up for publication. These two forms are illustrated below.

Financial Statement—Report Form

M. J. DUNCAN

FINANCIAL STATEMENT, DECEMBER 31, 1916

Assets

Cash		$1,250.19	
Notes Receivable		1,490.00	
Accounts Receivable	$3,675.40		
Less, Reserve for Doubtful Accounts	73.51	3,601.89	
Merchandise on Hand		6,720.81	
Insurance Unexpired		15.20	
Office Supplies Inventory		30.19	
Interest Receivable		10.41	
Delivery Equipment	$560.75		
Less, Reserve for Depreciation	93.46	467.29	
Furniture and Fixtures	$432.50		
Less, Reserve for Depreciation	43.25	389.25	
Total Assets			$13,975.23

Liabilities

Notes Payable		$1,000.00	
Accounts Payable		1,620.15	
Office Salary Accrued		25.00	
Total Liabilities			2,645.15
			[redacted]

Net Worth

M. J. Duncan, Capital, January 1, 1916		$10,000.00	
Net Profit for the year	$2,061.09		
Less, Net Withdrawals	731.01	1,330.08	
Present Worth			$11,330.08

Financial Statement—Account Form

M. J. DUNCAN

BALANCE SHEET, DECEMBER 31, 1916

Assets			*Liabilities*		
Cash		$1,250.19	Notes Payable		$1,000.00
Notes Receivable		1,490.00	Accounts Payable		1,620.15
Accounts Receivable	$3,675.40		Office Salary Accrued		25.00
Less, Bad Debts Reserve	73.51	3,601.89			
Merchandise on Hand		6,720.81	*Capital*		
Insurance Unexpired		15.20	M. J. Duncan, Capital	$10,000.00	
Office Supplies Inventory		30.19	Net Profit	2,061.09	
Interest Receivable		10.41		$12,061.09	
Delivery Equipment	$560.75		Drawings	731.01	11,330.08
Less, Depreciation	93.46	467.29			
Furniture and Fixtures	$432.50				
Less, Depreciation	43.25	389.25			
		$13,975.23			$13,975.23

Balance Sheet and Financial Statement Differentiated

With regard to the two forms under the titles "Financial Statement" and "Balance Sheet," it will be noticed that there is no essential difference; both show assets, liabilities, and net worth. While the titles as given are usually applied respectively to forms (1) and (2) as stated above, there is no reason why they may not be used interchangeably with either form and they will be so used hereafter. It will be noticed that form (1) is the expression of financial condition in accordance with the proprietorship equation stated as,

$$\text{Assets} - \text{Liabilities} = \text{Proprietorship}$$

whereas form (2) expresses it as,

$$\text{Assets} = \text{Liabilities} + \text{Proprietorship}$$

It is this grouping together of liabilities and proprietorship that has often led to an attempt to find points of similarity between these two fundamental classes of accounts.

Two Forms for the Profit and Loss Statement

The statement of profit and loss may also be made up in two forms, called the report and the account form, based on the same principles as the two forms of balance sheet just discussed. Explanation of the report form has already been given in Chapters VI and VII. The account form is very nearly a rescript of the ledger Profit and Loss account. It differs chiefly in that the information concerning "sales" which is summarized in the Sales account on the ledger is here set up in an inner column and shown summarized on the face of the statement. Similarly, the information developing cost of goods sold is summarized on the face of the statement. The two forms given below illustrate.

Profit and Loss Statement—Report Form

M. J. Duncan

Profit and Loss Statement, December 31, 1916

Sales			$19,478.90	
Less, Returns and Allowances			467.70	
Net Sales				$19,011.20
Merchandise Inventory, January 1, 1916		$5,187.51		
Purchases	$16,580.20			
Less, Returns and Allowances	1,590.10			
Net Purchases	$14,990.10			
In Freight and Delivery	279.80	15,269.90	$20,457.41	
Merchandise Inventory, December 31, 1916			6,720.81	
Cost of Goods Sold				13,736.60
Gross Profit				$5,274.60
Selling Expenses:				
Clerk's Salary		$1,140.50		
Delivery Expense		440.90		
Depreciation		136.71	$1,718.11	
General Expenses:				
Office Salaries		$720.00		
Light and Heat		40.70		
Office Supplies		95.41		
General Expense		590.17		
Insurance		36.20		
Bad Debts		73.51	1,555.99	3,274.10
				$2,000.50
Interest and Discount				60.59
Net Profit for the year				$2,061.09

Profit and Loss Statement—Account Form

M. J. DUNCAN

PROFIT AND LOSS STATEMENT, DECEMBER 31, 1916

Merchandise Inventory, Jan. 1, 1916	$5,187.51		Sales	$19,478.90	
Purchases	16,580.20		Less, Returns and Allowances	467.70	
In Freight and Delivery	279.80	$22,047.51			
Less, Returns and Allowances	$1,590.10		Net Sales		$19,011.20
Goods on Hand Dec. 31	6,720.81	8,310.91			
Cost of Goods Sold		$13,736.60			
Gross Profit, down		5,274.60			
		$19,011.20			$19,011.20
Selling Expenses			Gross Profit, down		$5,274.60
Clerk's Salary	$1,140.50				
Delivery Expense	440.90		*Other Income*		
Depreciation	136.71	$1,718.11	Interest and Discount		60.59
General Expenses					
Office Salaries	$720.00				
Light and Heat	40.70				
Office Supplies	95.41				
General Expense	590.17				
Insurance	36.20				
Bad Debts	73.51	1,555.99			
Net Profit, down		2,061.09			
		$5,335.19			$5,335.19
M. J. Duncan, Personal		$2,061.19	Net Profit, down		$2,061.09

In conclusion, it may be remarked that often in practice, after the adjusting entries are brought on the books, these periodic statements are first made up before bringing the closing entries on the books. This makes possible a proof of the work before any entries are actually made. Where this method is followed, the profit and loss statement may be used as a guide in writing up the closing entries on the journal, because the results shown there have been proven and the statement sets forth the amounts needed for the closing entries.

Problems*

(Assignment for Chapter XXX)

Make the adjusting and closing entries through the Journal for Lindsey's books. Calculate percentage of cost of sales, gross trading profit, selling expenses, general administrative expenses, and net profit. (Use "sales" as the basis.)

*See Problems at end of Chapter XXIX.

CHAPTER XXXI

THE CLASSIFICATION OF ACCOUNTS

The Purpose and Method of Account-Keeping

Accounts record the business history of a concern. The main purpose for which accounts are kept is to secure information as to the results of business activity and endeavor. The record required for this purpose can be made very brief, although the history of every business comprises a multitude of transactions covering a great mass of details. The whole scheme and method of account-keeping is designed chiefly to collect and summarize the detail and thus lose sight of the many items, using the detail mainly for the purpose of building up a summary which shall give in rapid review the entire record for the fiscal period. Account-keeping is to the bookkeeper what shorthand is to the stenographer—an abbreviated method of making the record. The uses to which the records are put, however, differ radically. Instead of being turned back again to the story in all its details, as in the case of the stenographer, the account balance or summary is really the starting point for further summarization and abbreviation to free the essentials from their non-essential elements and coverings in order to secure the bird's-eye view of the whole.

Classification of Accounts

It is evident from the above, that account-keeping. having so definite a purpose and end, must be carried out with great care in the original analysis and record. To aid in securing a record correct in the first instance, certain

fundamental groupings or classifications of accounts have been made. It is the purpose of this chapter to discuss the various account classifications proposed and to lay down fundamental considerations governing them.

Early Classifications

Perhaps, because originally accounts were kept only with persons, the first grouping, in point of time, was into personal and impersonal accounts, this being brought about at the time of the introduction of the present method of account-keeping as distinguished from the single-entry systems previously in use. The personal group includes all accounts with persons—customers, creditors, proprietor, and certain other accounts such as consignment and venture accounts which are not so clearly included in the personal group as the other three examples given. The impersonal group includes all others, i.e., those with other forms of assets as cash, merchandise, land; those with other forms of liability as notes and mortgages payable; those with expenses; and finally those with earnings or income.

In a controversy arising out of trouble with rival business colleges, Thomas Jones, writing in 1859 on the "Paradoxes of Debit and Credit Demolished," suggested a simple and, in most ways, a satisfactory classification of accounts. Jones was undoubtedly one of the first writers to get a true perspective of accounts and their use. Instead of building up his classification from a study of ledger accounts as usually kept, and attempting to find the points of similarity and of difference among them, he attacked the problem from the viewpoint of the final account summaries which he called the financial and the business statements, using the latter term to comprise the statement of profit and loss. Corresponding to these two summaries and based on them, all accounts in the ledger were classified by him as

primary and secondary. Those destined ultimately for the *financial* statement were primary; those for the *business* statement were called secondary. He even went so far as to show how business transactions result in increases and decreases of the two classes, when recording them on the books. So far as known, his attempt at a scientific classification was the first made by any American writer.

Recent Classifications

Using the same basis for their groupings as did Jones, later writers have classified accounts in various ways, referring to assets and liabilities as real, specific, and exterior; and to accounts belonging to the profit and loss statement and capital items, as nominal or representative, economic, and interior. All of these classifications are good and bring out different characteristics of the two groups.

Asset and liability accounts may be called "real" or "specific," because they represent, in the main, properties owned or owed which are definite and usually tangible. Perhaps, in a certain sense, liabilities are more real and specific than are assets. Still, either term connotes a true characteristic of the items covered. Exterior is used in the sense that the properties referred to and listed are "material factors *outside* of the proprietor, the only thing inhering in him being a right or claim to ownership in the 'net' properties." This class of accounts is sometimes further subdivided into personal and impersonal accounts, the former comprising all accounts with persons, i.e., customers, creditors, etc., while the latter include all other asset and liability accounts. This is the only correct use of these terms, personal and impersonal; that referred to in the preceding section being entirely wrong from the accountant's viewpoint, as will appear a little later after the fundamental requirements for a correct classification have been laid down.

The accounts used in the profit and loss statement, which explain the changes in the assets and liabilities within a stated period, are nominal in the sense that, in themselves, they represent nothing real but are only the names given to the forces and factors which have brought about certain conditions. In this same sense these accounts may be termed representative, although this title is also used as an alternative term for impersonal, this use being based on the personification theory that "cash" represents the "cashier" and "sales" the "salesman," etc. A better title is, perhaps, economic, inasmuch as they make record of the economic progress, the character of the management and the business economy practiced in the conduct of the enterprise. The term interior as applied to these accounts indicates that the factors recorded are at work inside the business, as distinguished from the outward or exterior showing of the real and tangible accounts.

Classification Used Here

The classification of accounts used in this work has been, in the main, a three-phase one, consisting of an asset, liability, and proprietorship nomenclature. The third group of accounts, proprietorship, is further divided into the two subclasses, temporary and vested, as explained in Chapter XIII. At the end of the fiscal period, after the ledger has been closed, there appear only asset, liability, and vested proprietorship accounts; but during the fiscal period, the temporary proprietorship accounts come into being and certain asset and liability accounts take on a mixed character resulting from the method in which we keep the record. This method is dictated not by a pure accounting theory, but by a theory bent to accommodate itself to the practical requirements of the average business. It is because the practical method of making the record falls short of a

theoretically exact method, that adjustments must be made before summarizing.

Thus, we do not make a daily record of the portion of our assets which has been consumed that day, but adjust any particular asset account at the close of each fiscal period, separating its asset and proprietorship elements. Also, when our note is discounted at the bank, we set up the face value as a liability, but from the standpoint of accurate accounting the face value of the note overstates the liability for the current period, unless the note comes due during the period or at its close. Only at its due date does the record make a showing of true condition. If the note falls due in a later fiscal period, the face value overstates the present liability by the amount of the prepaid interest charge belonging to the next period. Thus, a "practical" method of keeping the record necessitates the use of certain "mixed" accounts, but fundamentally the three-group classification given will answer every purpose.

Fundamentals of a Good Classification

In judging the fitness of a particular classification, the end and purpose for which the classification is made must always be the criterion. So, any classification of accounts must have in view the fact that all accounts lead up to the balance sheet and profit and loss statement, and that they must provide the summaries necessary for these statements. A large number of classifications may be made from different viewpoints and for different purposes, but a classification which is reasonable, carrying titles which clearly indicate the purpose for which the accounts are intended and therefore needing little or no explanation, is good. It is thought that the three-group classification—assets, liabilities, and proprietorship—meets these requirements.

Classifying Business Transactions

When making the record of business transactions on the books of account, it is necessary, first, to determine the main account group or groups affected by the transaction. After this is done, it is usually easy to determine which particular account in the group is affected. Great care must be used in the determination of the main groups, since a wrong determination results in an incorrect showing in the summary statements at the close of the fiscal period. To illustrate, in Chapter XIV reference was made to the fundamental distinction between capital and revenue expenditures, but when making the original entry of some transactions this difference is frequently lost sight of and what should be charged to an asset account is charged to some expense account or vice versa. The charging to an asset account, of items which rightly are expense items and therefore cut down the proprietorship element of the business, is one of the easiest ways of inflating the profits for a period and so of making a better showing than would be the case if the facts were recorded correctly. Correct classification of transactions is a matter of vital importance. An accurate analysis of every transaction must therefore be made before bringing it on the books. After determining the *main* group of accounts in which record is to be made, further analysis as indicated above is necessary in order to fit a particular transaction into its place under a suitable *account* title belonging to the main group.

Detailed Classifications

Frequently the more detailed grouping of accounts and the fitting of the transaction into them is treated under the general subject of classification. Such treatment deals, (1) with account titles in detail and what kinds and classes of transactions are to be recorded under particular titles, and

(2) with the arrangement and use of these detailed accounts in the various sections of the summary statements at the close of the fiscal period. It is not purposed to give this detailed consideration here. Certain broad principles have previously been stated dealing with the selection of the account title, the objection to the inclusion of unlike items under the same title, and the care to be exercised against a more detailed analysis than is required by the needs of the business. The chart of accounts shown below gives those accounts most frequently met and their customary groupings and classes, and will serve as a guide until the detailed classification can be treated in Volume II.

Chart of Accounts

Asset Accounts

CURRENT
- Cash
- Petty Cash
- Notes Receivable
- Accounts Receivable
- *Reserve for Doubtful Accounts**
- Merchandise Inventory
- Stocks and Bonds (for current investment)
- Accrued Income

DEFERRED CHARGES TO OPERATION
- Shipping Supplies
- Insurance
- Interest
- Office Supplies
- Etc.

*The items in italics in the above chart are to be handled as subtraction items from the account below which they are placed or from the group in which they appear.

FIXED

Furniture and Fixtures
Depreciation Reserve for Furniture and Fixtures
Delivery Equipment
Depreciation Reserve for Delivery Equipment
Buildings
Depreciation Reserve for Buildings
Good-Will
Etc.

Liability Accounts

CURRENT

Notes Payable
Accounts Payable
Dividends Payable
Accrued Expenses

DEFERRED INCOME

Rentals
Interest
Subscriptions
Etc.

FIXED

Mortgages Payable
Long-Time Notes Payable
Bonds Payable
Debentures
Etc.

Proprietorship Accounts

VESTED

Proprietors, Personal
Proprietors, Capital
Surplus (Profit and Loss)
Reserves of Profits (not valuation items)

TEMPORARY
- Income
  - Sales
  - *Sales Returns and Allowances*
- Expenses
  - Cost of Sales
    - Initial Inventory
    - Purchases
    - *Purchases Returns and Allowances*
    - Inward Freight and Cartage
    - *Final Inventory*
  - Selling Expenses
    - Salesmen's Salaries and Commissions
    - Salesmen's Traveling and Entertainment Expenses
    - Delivery Expense (wrapping, shipping room, horse and motor expenses, delivery salaries, etc.)
    - Outward Freight
    - Sales Management Salaries and Expense
    - Advertising
    - Depreciation on Sales Room, Equipment, Delivery Equipment, etc.
    - Sundry Selling Expense
  - General Administrative Expenses
    - Officers' Salaries
    - General Salaries
    - Stationery and Printing
    - Legal Expense
    - Postage
    - Telephone and Telegraph
    - Sundry Office Expense and Supplies
    - Depreciation on Office Building, Equipment, etc.

Light, Heat, and Power*
Rent†
Taxes†
Insurance†

Financial Management Expense and Income
Interest Expense
Bad Debts
Sales Discount
Collection Expenses
Interest Income
Purchase Discount

*Light, heat, and power expense should be distributed over the departments using it; selling to be charged with its share and general administrative its share.

†These items are sometimes treated as Financial Management expenses or are distributed partly to Selling and partly to General Administrative where an equitable basis for distribution can be determined.

Practice Data

(*Assignment for Chapter XXXI*)

This set comprises one journal blank, one ledger, and a cash book. These books will be used in the Practice Data of Chapters XXXII to XLV. First, page each blank consecutively beginning with the first page, excluding the index pages of the ledger. Of the journal blank, pages 1-13 inclusive will be used for the general journal, pages 14-18 inclusive for the sales journal, and pages 19-21 inclusive for the purchase journal; pages 22-45 inclusive will be used for the trial balances as explained later. Of the ledger blank, pages 1-19 inclusive will be used for the general accounts, pages 20-31 inclusive for customers, and pages 32-35 inclusive for creditors. The sales, purchases, and general journals will be used as in the previous set. The cash book has three columns, the first on each side being used as a sundry column in which all amounts must be entered first; the second column is for Sales Discounts on the receipts side and Purchase Discounts on the disbursements side; and the third column is the "Net Cash" column. The cash balance is always the difference between the two net cash columns. When entering a sale or purchase transaction from which a discount

is to be taken, the gross amount of the invoice is entered in the "Sundry" column, the discount in the discount column, and the net cash in the third column. In this way the extensions and additions may be proved, the sundry column total equalling the sum of the totals of the other columns.

In handling the accounts of customers and creditors, daily postings and a careful observance of terms of credit will be necessary.

The purpose of this set is primarily to give facility in the use of the various journals and in handling quickly a volume of transactions, summarization of the books, and the taking of monthly trial balances. To secure these features without too detailed work on the student's part, transactions are summarized for the month and are to be entered under date of the last day in each month. Where needed, as for interest calculations on notes, etc., specific dates are given.

Before making any entries, familiarize yourself thoroughly with the accounts to be kept in your ledger and adhere strictly to that classification. Open the following accounts in your ledger at the places indicated. The first numeral following the account title indicates the page, the second the line on that page. By "line 1" is meant the very first line at the top of the page.

Lewiston School Bonds....1, 1
Notes Receivable...........1, 13
Reserve for Doubtful Accts.1, 25
Merchandise Inventory.....2, 1
Electric Light Deposit......2, 13
Horses, Wagons & Harness.3, 1
Depreciation Reserve for Horses, Wagons & Harness......................3, 13
Store Furniture & Fixtures.4, 1
Depreciation Reserve for Store Furniture & Fixtures....................4, 13
Office Furniture & Fixtures....................5, 1
Depreciation Reserve for Office Furniture & Fixtures....................5, 13
Notes Payable..............6, 1
O. W. Ward, Loan..........6, 13
O. W. Ward, Capital........7, 1
O. W. Ward, Personal......7, 13
C. Gneisel, Capital..........8, 1
C. Gneisel, Personal.........8, 13
Profit and Loss.............9, 1
Sales 10, 1
Sales Returns & Allowances 10, 13
Purchases 11, 1
In-Freight & Cartage......11, 13
Purchases Returns & Allowances 11, 26
Salesmen's Salaries.........12, 1
Salesmen's Traveling Expense 12, 13
Advertising 12, 25
Shipping Expense..........13, 1
Shipping Supplies..........13, 15
Out-Freight 13, 27
Rent 14, 1
Insurance 14, 13
Light, Heat & Power......14, 25
Depreciation 15, 1
Office Salaries.............15, 13
Office Supplies.............15, 25
Office Expense.............16, 1

General Expense...........16, 13
Cash Short & Over........16, 25
Charity Donations..........17, 1
Credit Men's Association
Membership 17, 13
Sales Discount.............17, 24
Bad Debts..................18, 1
Miscellaneous Sales........18, 13
Interest Cost..............18, 25
Purchase Discount.........19, 1
Interest Income............19, 13

On pages 20-31 inclusive enter the following customers' accounts, four to the page:

Quinn Bros.
Stewart & Son
J. Jackson
S. Koenig
Jacob Green
Gristede Bros.
M. J. Downing
Dodts' Grocery Store
Casazza & Sons
Capella Bros.
S. Brown
Four Corners General Store
Black Hills Mining Co.
Blue Front Grocery
R. B. Kennan
J. Johnson
Bull's Eye Mining Co.
Badgley & Stewart
Dewey Brown
Evans Sons
Fred Henry
M. E. Dietrich
Jas. Butler, Inc.
C. A. Gerken
John Johnson
Fein Bros.
M. Heitzman
H. A. Krebs
Andrew Davey
Wm. Crick
Russo Bros.
Progressive Stores Co.
J. Perlman
P. Peterson
Uintah Copper Co.
Circle Bar Ranch
J. R. Rice
Al Morton
J. J. Tommich
J. Henry Witt
U. B. Zipkin
Las Vegas Cattle Co.

Beginning on page 32, enter these creditors' accounts, four to a page.

Swift & Co.
Korn Products Co.
F. Mezzadri
Austin, Nichols & Co.
Reid Murdock Co.
Armour Packing Co.
Grand Grocery Co.
Holland Gelatine Works
Kataguri Bros.
Van Dusen Co.
Delico Food Products Co.
United Supply Co.
Federal Macaroni Co.
Washburn Crosby Co.

CHAPTER XXXII

THE TWO BASIC METHODS OF ACCOUNTING AND SOME APPLICATIONS

Accounting, Its Field and Method

Pixley divides the field of accounting into three parts: the constructive branch, the recording branch, and the analytic or critical branch. Whether there is any particular advantage in such a division of the field is doubtful. To a beginner it may set out more clearly the scope of the work, but it does not show the method of approach and attack necessary for the satisfactory handling of the problems of accounting.

However, the first branch embraces the principles underlying the records, the *construction of systems* to record the data required for intelligent management and control and to exhibit them in the form of periodic statements.

In the second branch Pixley includes the methods of making the various records needed for the accounting of all the activities of modern business. The recording branch rests, therefore, upon the constructive, takes its direction from it, and exhibits the data and results contemplated and mapped out by it.

The analytic branch comprehends the field of auditing. Montgomery in his "Auditing, Theory and Practice" says: "Auditing is the analytical, as practical accounting is the constructive, branch of accountancy," going on to say that the auditor is something more than an analyst, however. Without question, the statement brings out the controlling mental qualities needed by the accountant. He must be

able to analyze facts, data, and conditions and build them into an instrument for the guidance of the business executive. He uses in his work the basic methods of analysis and synthesis; or in the language of the logician, the methods of induction and deduction.

Analysis and Synthesis

Analysis is the "resolution or separation of anything which is compound, into its constituent elements or into its causes." In its root language, the Greek, its controlling idea is a loosening, a breaking up, and it has come to mean the freeing of an idea, fact, or condition of its extraneous elements and thereby getting at the essentials. Synthesis is the "combination of separate elements or objects into a whole." In its Greek form it gives the fundamental idea of putting several things or elements together, and it has come to mean the constructing out of the facts and essential conditions developed by analysis something to show a way of action, a policy to govern the conduct for the future. Just as the lawyer must make a careful and thorough analysis of the data and conditions involved in his case, working his way to essential and underlying facts and must then rebuild his structure in the light of well-established principles, showing their application to the essential facts discovered; so must the accountant work, proceeding by the methods of analysis and synthesis.

He must, in the first place, make a study of the business and obtain a knowledge of any particular information desired by the owners; in other words, he must make a careful analysis of all conditions, and then devise a method or system for the record of business dealings that shall furnish classified and partially summarized information with regard to all business activities. These data must be so combined as to bring out their proper relationships to the underlying

forces of the business, and to show the final results for the period in correct perspective. This ability to weigh, judge, relate, and set forth with accuracy and truth the vital data of business, to make a diagnosis on which must rest the policy for the future—this is the type of ability demanded of the accountant by modern business.

For this reason the student, in doing his daily assignment, should never be content with a formal solution of a problem or a technically correct record of business dealings, but should always attempt to apply underlying principles, to see the detail work in the light of the goal to which it leads. He must see the bearing, the relation which every item has to the whole; he must allow the end towards which he is working to give direction and guidance to his effort. Otherwise his work is empty and parrotlike.

Analysis and Synthesis Applied to Account Classification

Thus, in our classification of accounts, the first or main groups follow closely the three general divisions of the financial statement. For purposes of detailed information, however, this threefold division has been found insufficient. So subdivisions of these main groups of assets, liabilities, and proprietorship must be made, the minuteness of subdivision being determined by the amount of detail desired. That system of accounts which groups only one kind of data under each particular account title is better than a system which mixes its records by grouping dissimilar data under a single head. Yet, caution against too great detail, an unnecessary multiplication of accounts, is always to be exercised. Oftentimes essential facts and forces of business activity are lost sight of in a maze of detail.

The reasons for making certain groupings of the assets and liabilities on the basis of degree of liquidity and the advantage resulting from this grouping when making the

summary statements for the period, were discussed and illustrated in Chapter IV, and it may be pointed out here that this affords an example of the analytic and synthetic method and procedure constantly to be employed by the accountant.

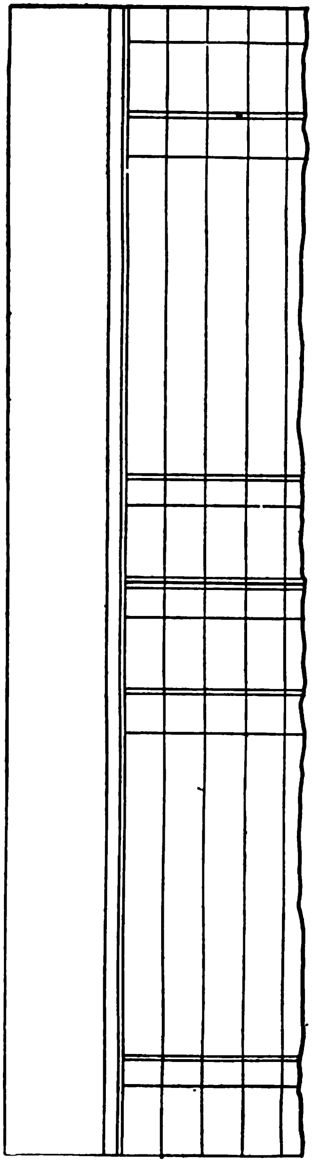
The Ledger; an Example of Analysis and Synthesis

The book which, in the constructive work of the accountant, shows the application of these two methods of attack and procedure is the ledger. The ledger was defined as the book of accounts. The account is a device for summarizing business data of a similar or exactly opposite character. The ledger is analytic in its structure; the account is synthetic in its method. Before it can be determined what accounts are to be kept in the ledger, a careful survey must be made of the requirements of the business, what information is needed, and in what form such information is to be presented. This having been determined by an analysis of all the facts and conditions involved, the purpose of the ledger is to collect these facts under their respective account titles and so to summarize all the data of the business. Thus, the ledger is not only a classified, but also a summarized or grouped record. From the viewpoint of the information furnished, the ledger is the most important of the account books

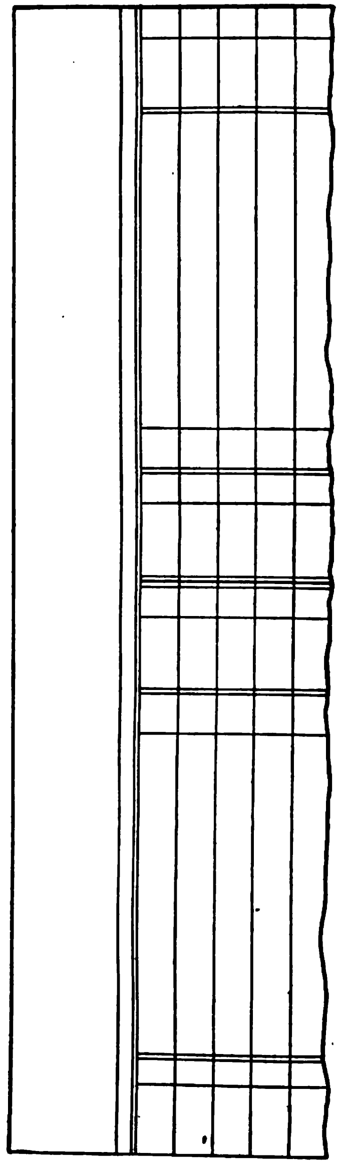
There are several kinds of ledgers, which may be classified (1) as to their rulings and (2) as to their bindings.

1. Rulings

As to their rulings, ledgers are either standard, balance, or progressive. The standard ruling has two duplicate parts, a debit and a credit, and is usually divided-column, one money column appearing at the extreme right of each part, although sometimes the arrangement is symmetrical



Standard Ledger—Divided Column



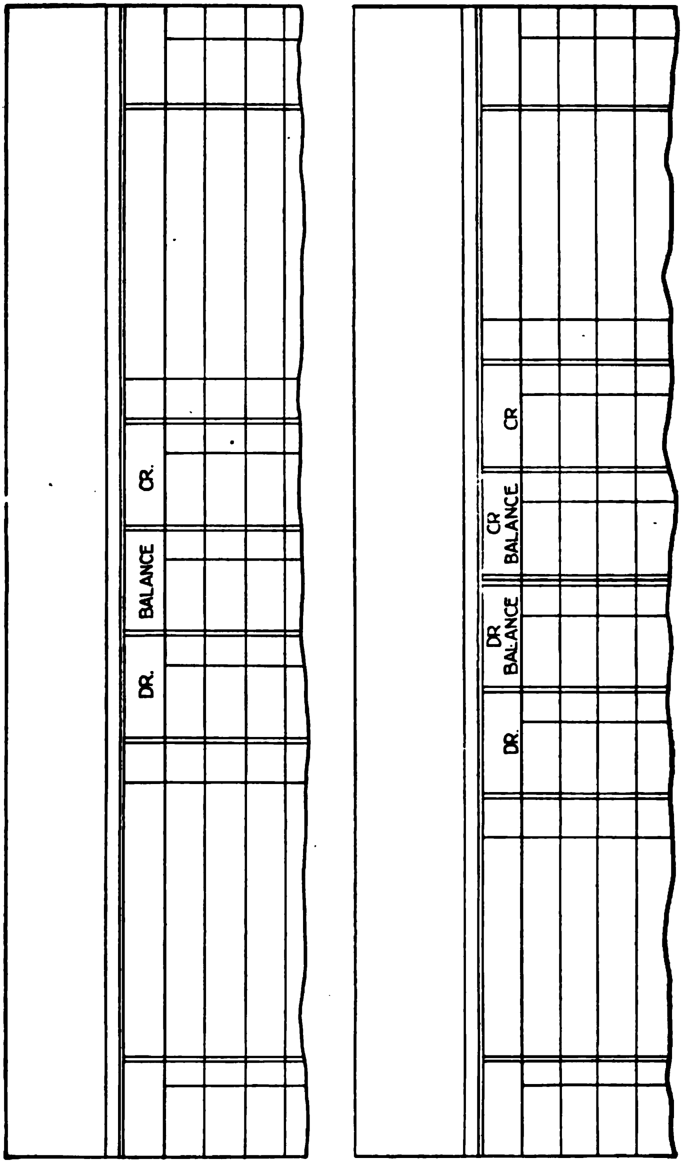
Standard Ledger—Center Column

with both debit and credit money columns at the center, and the date columns at either side of the page. (See page 262.)

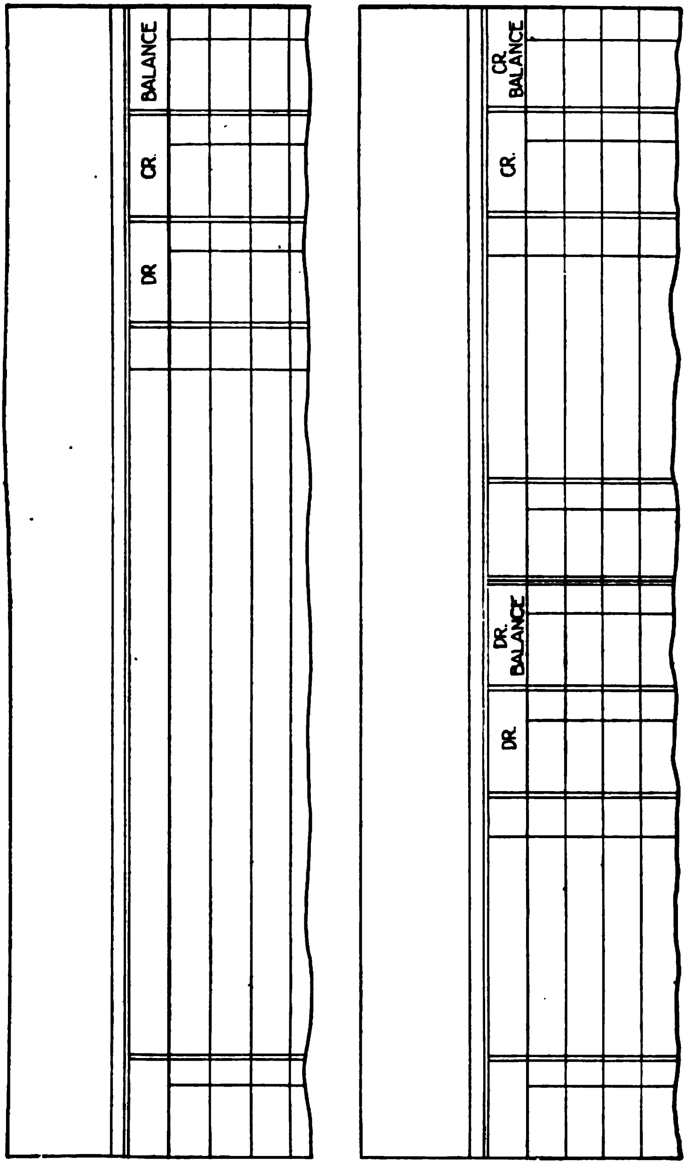
The balance ruling is a three- or four-column ledger with the money columns either at the center or at the right-hand margin, or at both the center and the right-hand margin. The extra columns are for the account balances. If the balance is usually either a debit or a credit, only one balance column would be necessary; where it is apt to be a debit at one time and a credit at another, a debit balance column and a credit balance column are advantageous. The balance ruling is used particularly with personal accounts where there is need for an up-to-date balance. Where this kind of ledger is used, entry of new debits or credits should always be on the next blank line as shown in the balance column, so as to allow the extension of the new balance opposite the last entry even though this should leave blank several of the preceding lines on the debit and credit sides. Typical forms of some of these are shown on pages 264 and 265.

The Progressive Ruling

The Boston, progressive, or tabular ledger, as it is variously called, makes provision for a *horizontal* progress of the account as to sequence of time; the title of the account is written at the left-hand margin, allowing one or more lines to each according to the degree of activity of each. The account title is written once at the left margin of the master or main sheet, and is sometimes repeated at the right margin, if the sheet is very wide. The page is divided into columns for each day of the period. To effect this, short-margin insert sheets must be bound in to give the desired room for accommodating a whole period's record. This style of ruling has been much used for depositors' accounts in a bank where a daily balance for each is necessary. It is capable of



Balance Ledger Rulings



Balance Ledger Rulings

DEPOSITORS		MONDAY			TUESDAY			WEDNESDAY			
NAMES	BALANCE	CHECKS	DEPOSITS	BALANCE	CHECKS	DEPOSITS	BALANCE	CHECKS	DEPOSITS	BALANCE	
John Smith	500 00	200 00		300 00	150 00	1000 00	1150 00	etc.			

Boston Ledger Sometimes Used for Depositors

adaptation to other uses, however. One form is shown on page 266.

2. Bindings

Ledgers may be classified also as solid-bound, loose-leaf, and card; the titles being self-explanatory. One of the great advantages of the loose-leaf and card ledgers over the solid-bound ledger is their flexibility. They lend themselves easily to any desired grouping of the accounts; they may be numerically arranged where accounts are numbered instead of named; they may be arranged as to classes and each class made self-indexing; a geographical grouping may be made. Another great advantage is the ability to discard or file away in other binders all "dead" accounts, thus making for ease and facility in the use of the "live" ledger. Also it is possible for several clerks to work simultaneously, since the leaves or cards are removable and may be distributed among any number of clerks. There is always the danger, however, of a failure to return a leaf or card, or of placing it out of regular order when returning it, or of destroying it, if it were desired fraudulently to do away with any particular account. The use of loose-leaf and card ledgers for personal accounts is pretty thoroughly established, notwithstanding the disadvantage just mentioned.

Method of Arranging Accounts in the Ledger

As to the order of arrangement of accounts in the ledger, one principle governs. Arrange all accounts in such a manner as to facilitate the drawing up of the final statements. Thus, assets should come first in the degree of their liquidity or availability, each valuation account following its particular asset; and the liabilities should be arranged in a similar order. Then would come the proprietor's ac-

counts, the summary Profit and Loss account, and the income and expense accounts in the order in which they are to be used in the statement of profit and loss. Where only one ledger is kept the personal accounts receivable and payable are usually recorded in distinct groups, after all the other accounts, towards the back part of the ledger rather than in the position required by the principle just stated. A trial balance taken from a ledger in which the order of arrangement of the accounts is strictly in accordance with this principle, is called a classified trial balance.

Practice Data*

(*Assignment for Chapter XXXII*)

O. W. Ward, who had conducted a very profitable retail grocery at Big Falls, sold his business for $15,000 and moved to St. Paul to enter into a partnership with C. Gneisel for the purpose of carrying on a wholesale grocery business under the firm name of Ward & Gneisel. Ward's investment was $12,500 cash and Gneisel contributed the following assets at the values stated, which had been agreed upon by the partners: two notes receivable in his favor; one for $1,000, signed by J. B. Jackson, non-interest-bearing for 60 days, due February 4; the other for $1,500, signed by A. M. Scott, interest at 6% for 3 months, due March 8—both accepted at face value; a stock of groceries valued at $5,893.25; delivery equipment $500; fixtures for store $1,000; furniture in office $150; and cash necessary to bring his investment to an equality with Ward's. The partnership agreement provided that Ward was to be allowed a salary of $1,800 per year and Gneisel $1,500; that each was to be charged with interest at 6% on any drawings in excess of salary from the date such drawings exceeded the salary for the half-year until the date of closing the books; that profits and losses were to be shared equally; and that the books were to be closed twice yearly on June 30 and December 31 respectively. Make the opening entries in Journal and cash book for the above. Post these entries immediately.

*See Practice Data for Chapter XXXI.

Summarized transactions for the month of January were as follows:

Purchases—Swift & Co., 2/5, n/30, $512.50; Korn Products Co., 3/10, n/60, $857.90; F. Mezzadri, 8/5, 5/10, 2/30, n/90, $962.50; Austin Nichols & Co. 5/5, n/30, $1,403.25; Reid Murdock Co., 3/5/, 2/20, n/30, $1,865.05; Armour Packing Co., 2/20, n/30, $1,511; Grand Grocery Co., n/10, $2,667; cash purchases, $134.75.

Sales—Quinn Bros., n/10, $2,189.60; Stewart & Son, 1/5, n/30, $3,942.75; J. Jackson, n/5, $2,500.25; S. Koenig, 2/10, n/30, $4,189.40; M. E. Dietrich, 2/5, n/60, $2,140.50; Jas. Butler, Inc., n/5, $3,772.37; C. A. Gerken, 3/10, n/30, $4,125; John Johnson, 1/30, n/60, $1,819.15; Jacob Green, 3/5, n/30, $2,237.40; Gristede Bros., 1/10, n/30, $3,100.95; M. J. Downing, 2/10, n/30, $1,680.40; Dodt's Grocery Store, 3/5, n/20, $1,517.18; cash sales $567.45; Ward drew groceries, $50.

Journal—M. E. Dietrich returned unsatisfactory goods, $250.90; made C. A. Gerken allowance of $325 for goods lost in transit and filed claim against the C. N. W. Ry. for the amount; returned Reid Murdock Co. spoiled goods, $125; received 6% 60-day note, due March 28, from Gristede Bros. for January bill $3,100.95 less a special discount of 10%.

Cash Receipts—excluding those listed above: Quinn Bros., January bill $2,189.60 net; S. Koenig, January bill $4,189.40 less 2%; M. E. Dietrich, balance January bill $1,889.60 less 2%; C. A. Gerken, balance January bill $3,800 less 3%; Jacob Green, January bill $2,237.40 less 3%.

Cash Disbursements—excluding those listed above: bins, shelving, partitions, counters, etc., for store $2,500; desks, tables, typewriters for office $580.20; new horse $300; deposit for electric current meters $50; sales salaries $2,500; sales traveling expense $2,650.50; advertising $2,180.95; shipping clerks $750; lumber, boxes and other packing material $120.80; freight and drayage bills $310.30; rent of store for January $250; insurance January 1, 1917 to January 1, 1918, $116.80; coal $90; light $10.82; office salaries $500; moving office partitions $50; account books, stationery, stamps, etc., $125.90; janitor and watchman wages $91.80; gift to deaf asylum $25; Ward, $150; Gneisel $125; Swift & Co. January bill $512.50 less 2%; Korn Products Co., January bill $857.90 less 3%; Reid Murdock Co., balance January bill $1,740.05 less 3%; rent for February $250; F. Mezzadri, January bill $962.50 less 8%; Austin Nichols & Co., January bill $1,403.25 less 5%; Armour Packing Co., January bill $1,511.00 less 2%; bought 5 Lewiston School Bonds, bearing 6% interest, par $1,000, at 101 and accrued interest for 60 days, coupons due November 24 and May 24; there was a cash shortage of $1.25.

Instructions

Enter the investment transactions complete in the Journal, checking the "cash" items. Be careful to enter all cash transactions in the cash book whether listed under "Cash" above or not.

In entering the purchase of Lewiston bonds in the cash book charge "Lewiston School Bonds" account with the cost value and "Interest Income" with the accrued interest. The transaction means that he paid $1,010 for each bond and bought out the seller's right to the interest earned up to the date of sale. The entry of this accrued interest to the debit of Interest Income will offset the credit to be made there when the interest for the six months is received, and thus show, by the balance between the two entries, the true earning for the period during which the bonds were held.

No record is made on the books of account of the claim for loss filed against the railroad company. Were there many such claims, a "Claims Record" book would be used as a memorandum record.

The word, balance, as in the phrase, "C. A. Gerken, balance January bill less 3%" calls attention to an adjustment of some sort—returns or allowance—to be considered in determining the amount still due.

It will be noted that some transactions are, on their face, for a longer period than the 6-months period under review. It is suggested, as a convenient method for keeping track of all such data which will have to be adjusted at the end of the period, that page 48 in your Journal be used as a memo for this purpose. Make record there of original date, term covered by the payment, amount, and particulars of the transaction. For example, the 1 yr. insurance policy of Jan. 1 is an item of which to make memorandum record here.

CHAPTER XXXIII

PARTNERSHIP FROM THE BUSINESS VIEWPOINT

Partnership Defined

In Chapter III, reference was made to some of the features of a partnership—the purpose of its formation, advantages, disadvantages, etc. The laws of the State of New York define a partnership as follows: "A partnership, as between the members thereof, is the association, not incorporated, of two or more persons who have agreed to combine their labor, property and skill or some of them for the purpose of engaging in any lawful trade or business, and sharing the profits and losses as such between them."

This definition brings out in a general way the reasons for the formation of the partnership and its essential features. Under this type of organization, where several persons combine their capitals, it is possible to secure a larger fund of capital than under the sole proprietorship. This opens to the partnership avenues of business usually closed to the sole proprietor. The bringing together of the man with a special aptitude or skill along certain lines, or of a man with a following in the community on account of social standing and acquaintanceship, with another who has money or a plant for the operation of a business, often makes successful an otherwise unpromising undertaking.

Operating Feature and Working Organization

Mutual agency is the essential operating feature of the partnership. Except in the case of a limited partnership, to be mentioned later, each partner has an equal voice in the

management and control of affairs. Unlike the corporation where for management purposes the owners' powers are delegated to a controlling board, the essential character of the partnership is that each partner has, regardless of the amount of his investment, an equal right in the direction of its business. As between themselves, for purposes of division of duties and specialization of efforts, definite power to exercise control over certain features of the business may be delegated to individual partners. But such delegation means nothing more than a method of dividing the work and is simply the working organization of the firm which may be changed at any time the majority of the partners see fit. Thus, while a partner may be limited in his actions for the firm by agreement among the partners, so that he is not a general agent for the firm, still as to outsiders who know nothing of this internal arrangement, he has power to bind the partnership by his acts, because an outsider has a right to expect that any partner has power to act as an agent for the firm. This is so because such power is of the essence of the partnership form.

Essential Characteristics of the Partnership

Limited life is an essential characteristic of the partnership. The partnership relation is a very personal one. It can be terminated in a number of ways, but the death or retirement of any member automatically works a dissolution of the firm, even though another man takes his place. The legal theory is that the old partnership is dead and a new one, even though bearing the same firm name, has come into existence. Thus a partnership cannot be perpetual. The relationship between the partners is so intimate that the success of the undertaking depends fundamentally on the good faith and honor exercised by each partner towards the others, and therefore, any addition to the personnel of a

partnership can be made only with the consent of all members of the existing firm.

The partnership being the outgrowth of the sole proprietorship, certain of the aspects of the earlier form still cling to it. For suit at law it is looked upon as a collection of single owners, and action on contract must usually be taken against the individual members of the firm. Suit by or against the partnership cannot, as a rule, be brought in the firm name. Some states, however, allow this under recent enactments. Title to personalty can be held and transferred under the firm name, but realty must be in the name of the individual members or in the name of one member acting as trustee for the firm. Thus, while in the view of the business community, the copartnership is a business entity under a firm name, in the sight of the law it is not an entity but merely a collection of single owners. This legal view accounts also for the full debt liability of every partner—except in a limited partnership. In case the firm assets are insufficient to meet the claim of creditors, any or all the partners' private resources may be levied.

Co-ownership of the profits of a business is another feature essential to the copartnership. No sharing in the profits on any other basis than that of co-ownership will constitute a partnership. When the question comes before the courts, the intention of the parties governs, and evidence showing that each acted as principal for himself and as agent for the others, and has shared profits as profits, would be sufficient to constitute the relationship.

The Partnership Contract

A partnership being a contract relationship, all the requirements governing legality of contracts, such as agreement, consideration, lawful object, competency of contracting parties, etc., apply to the copartnership. The contract

may be oral or in writing. In case of dispute an oral contract, on account of the difficulty of proof, is of little force in regulating the relations of the partners, and the general law of partnership would usually govern. Inasmuch as there is so great an opportunity for disputes in a relationship of this sort, it is imperative, if efficient working relations are to be maintained, that very carefully drawn articles of copartnership be agreed upon before active business is begun. These articles should contain, at least, the following:

1. The name of the firm and of the partners.
2. The kind and place of business.
3. The duration of the partnership
4. The method of terminating it.
5. A detailed statement of the relations between the partners, such as duties and powers, capital contributions, withdrawals of capital, salaries, division of profits and losses, interest on capital, and the time of closing the books to secure a definite determination of the partners' interests.

Even when the utmost care is exercised in drafting the articles of partnership, it almost always happens that some portion is not understood alike by all or that some contingency arises not specifically provided for. Nevertheless, it is the only way in which a comparative avoidance of misunderstanding and dispute can be obtained.

Partnerships Classified

As to the scope of their business operations, partnerships are usually classified into general and special. The general class embraces those for the conduct of some general or ordinary lines of business. The special class comprises those formed to undertake a definite task or some particular

line of business. Joint ventures would come under this latter class.

As to the liability of their members, partnerships may be classified as general and limited. The general partner has the full liability, referred to above; the limited partner's liability never exceeds the amount of his investment. In a limited partnership one or more, but not all, members may limit their liability. This class of partnership can be formed only under direct authority of statute law. A limited partner is not active in the management of the business, being more in the nature of a lender of money to the firm, who gets his return in profits instead of interest. Should he become active in the firm's management, he will constitute himself an ordinary partner with full liability. The New York statute governing the formation of the limited partnership is as follows:

> Two or more persons may form a limited partnership which shall consist of one or more persons of full age, called *general* partners, and also of one or more persons of full age who contribute in actual cash payments, a special sum as capital, to the common stock—or fund—called *special* partners, for the transaction within this state of any lawful business, except banking and insurance, by making, severally signing and acknowledging and causing to be filed and recorded in the clerk's office in the county where the principal place of business of such partnership is located, a certificate in which is stated:
>
> 1. The name or firm under which such partnership is to be conducted and the county wherein the principal place of business is to be located.
> 2. The general nature of the business intended to be transacted.
> 3. The names, and whether of full age, of all general and special partners therein, distinguishing which are general and which are special partners and their places of residence.
> 4. The amount of capital which each special partner has contributed to the common stock—or fund.
> 5. The time at which the partnership is to begin and end.

Affidavit of the payment of capital must be made and a notice of the formation of the partnership published in a

paper of general circulation. The limited partnership is thus hedged about with safeguards for creditors, bankers, and other interested parties, particularly by the rule that a limited partnership cannot exist unless there are one or more general partners with full liability.

The Joint-Stock Company

The joint-stock company is a partnership or association in which ownership and voice in the management, and profit-sharing ratio are evidenced by transferable shares of stock. Control and management are exercised through a board of directors chosen by the stockholders. If the company becomes bankrupt and the firm assets are insufficient to satisfy creditors, the members are personally liable to the full extent of their private property in the same way as in a general partnership.

The mining partnership is a form of joint-stock company which operates in mining communities. Usually the mining property itself is beyond the scope of such a partnership, only the development of this property by means of a lease being contemplated. Of course, the profits arising from such development are within the scope and for the benefit of the mining partnership.

Partners Classified

Finally, brief mention may be made of the following different classes of partners, all within the ordinary partnership:

1. Ostensible partners—those who hold themselves out and are known as partners.
2. Nominal—those who are known as partners but who have no real interest in the firm.
3. Dormant or silent—those who are not known to

outsiders as partners and who take no active part in the management of the firm's affairs.

4. Secret partners—those who are not known as partners to outsiders but who have an interest and take active part in managing the firm.

For more detailed information as to a partner's rights, duties, and responsibilities to his copartners and to outsiders, a standard legal text on partnerships or business law should be consulted. The student should also read Chapter III in connection with this chapter and the next.

Practice Data*

(*Assignment for Chapter XXXIII*)

Summarize the sales and purchase journals, balance the cash book, and post completely all books of original entry. The sales and purchase journals will be summarized as in the J. M. Butcher problem (at end of Chapter XXVII). Before balancing the cash book, draw a total line for the "Sales Discount" column on the debit side, enter the total on the first blank line, writing in the explanation column opposite it, "Sales Discount, Dr." This is the item which will be posted. Handle "Purchase Discount," similarly on the credit side, and enter the "Balance" of cash on hand on the next line below, extending it to both the "Sundry" and "Net Cash" columns. Now rule both sides on the same relative lines, show totals for all three columns, and bring down the balance, extending it in both columns.

Take a trial balance of your ledger, being sure to include the cash balance, and record it under date of January 31, beginning on page 22 of the Journal blank. Write "Trial Balance 1917" at the top of the page and in the small space over the money columns "January 31." Reserve the first line of your trial balance for "Cash." From the ledger, copy the names of *all* accounts—whether or not there are as yet any entries in them—in the order there shown. Be careful to

*See Practice Data for Chapter XXXII.

write the account name at the extreme left of the "Explanation" space, close to the "Date" column. Leave one line at the bottom of the page for "Totals forward"; likewise one line at the top and bottom of pages 28, 34, and 40. Since one page is not sufficient to complete the record, continue it on pages 28, 34, and 40, there recording the rest of the accounts and heading the page and columns as on page 22. The intervening pages will be used as shown in Practice Data of Chapter XXXV.

CHAPTER XXXIV

PARTNERSHIP FROM THE ACCOUNTING VIEWPOINT

From the fact that the law looks upon the partnership as a combination or collection of sole owners, some of the accounting problems arising out of the partnership form are unique and a partial or full treatment of these problems will be given in this chapter.

Profit-Sharing in the Partnership

Of these problems perhaps the one occurring most frequently is that concerning the division of profits. Attention was called in Chapter XXXIII to the need of explicit statement on this point in the articles of copartnership under the head of the inter-partnership relations. Since men combine their capitals for the purpose of realizing profits, it would naturally be supposed that all partnership agreements would be specific on that point. Yet it very often happens that many contingencies relating to the matter of profit-sharing have not been foreseen and as a result disputes arise. This is frequently the case, either because the articles were drawn up by a person—usually a lawyer—unfamiliar with partnership problems from the accountant's point of view, or because more or less formal agreements were entered into by the partners themselves without consulting others who might have been in a position to foresee certain contingencies and provide for them in the articles.

The fundamental principles governing profit distribution may be stated as follows:

1. Where the agreement is silent, the law provides that profits shall be divided equally among the partners regardless of the amounts of their respective investments of capital. Some partners may have made no investments of money or property, setting up their particular skill and aptitude or standing in the community as their share and contribution to the profit-earning capacity of the organization. Unless it is specifically agreed otherwise, these will share equally in any profits.

2. Where profits are to be shared in the same ratio as capital, the agreement should specify whether the basis of division is to be the original investments or the capitals as shown at the beginning of each period, which would be the original investments plus profits left in the business. This latter interpretation would usually result in a changing ratio for succeeding periods, whereas under the former interpretation the ratio of profit-sharing would be always the same.

3. Provision should be made, either in the original articles or at a subsequent time, for a change in the profit-sharing ratio in the event of a partner's withdrawing some portion of his original investment if such withdrawal is allowed. It may be stated here that an agreement between the partners as to any ratio for division of profits can be made at any time and will govern such ratio, but must be on a determinable basis.

4. Where the articles are silent as to the division of losses, the profit-sharing ratio governs. Where a different ratio is desired, specific statement of it must be made. Of course, upon the inception of an undertaking losses are not contemplated, but the experience of others should cause provision to be made for apportionment of losses in order to avoid possible difficulties or disputes.

5. Unless the articles—or subsequent agreements—pro-

vide for the payment of salaries to any or all of the partners, none are allowed.

6. The conditions governing the partners' drawings should be explicit as to the amount to be drawn during a given period. It should be stated explicitly whether excess drawings shall be regarded as a charge against capital, or as the basis for an interest charge, or simply as an excess drawing standing in the partner's current account without penalty other than a disallowance of future drawings until lapse of time brings the total amount drawn within the agreed limitations.

Average Investment as a Basis for Profit-Sharing

Attention should be called to a basis not frequently employed, except in some cases of special partnerships entered into for the construction of a specific contract or for doing any special work. In these cases the capital needed may not be known at the start or, if known, may not all be required then, but is to be furnished by whichever partner may have available funds at the time of need. In such cases the basis of profit-sharing may be made the amount of capital furnished by each partner and the length of time of its use in the enterprise. Two methods of determining the ratio may be employed.

First Method. Each investment may be multiplied by the number of days occurring between the date on which the investment was made and the date of profit determination, giving a result which may be called day-dollars of investment in a sense similar to the term foot-pound in physics. From the total day-dollars of investment must be subtracted the day-dollars of withdrawals, arrived at similarly, thus showing net investment in terms of day-dollars. The sum of all the investments in day-dollars becomes the basis on which to prorate profits, each partner's share being the part

which his individual net investment bears to this total net investment.

Second Method. The original investment of each partner may be multiplied by the time it remains unchanged, i.e., until it is added to or some portion is withdrawn. Similarly, this changed capital is multiplied by the time it remains fixed, and so for every change. The total of these items constitutes each partner's net investment, from which the profit-sharing ratio is determinable as above. In the problem given below, to shorten the operations the dates are so taken that calculation can be made on a month-dollar instead of a day-dollar basis. The capital accounts of the partners, showing investments and withdrawals, are as follows:

A. B. CARD

1917			1917		
Jan.	15	$2,500.00	Jan.	1	$10,000.00
Apr.	1	4,500.00	Mar.	15	7,500.00
June	15	1,500.00	June	1	5,000.00

D. E. FOLWELL

1917			1917		
Feb.	1	$3,000.00	Jan.	1	$5,000.00
May	15	2,000.00		15	5,000.00
			Apr.	1	5,000.00
			June	15	2,500.00

Profits as on July 1, 1917, were $5,000. Determine each share.

Solution

(Using the second method.)

A. B. Card:

Amount		Months	Month-dollars	
$10,000	×	½	$5,000	
7,500	×	2	15,000	
15,000	×	½	7,500	
10,500	×	2	21,000	
15,500	×	½	7,750	
14,000	×	½	7,000	
		6		$63,250

D. E. Folwell:

$5,000	×	½	$2,500	
10,000	×	½	5,000	
7,000	×	2	14,000	
12,000	×	1½	18,000	
10,000	×	1	10,000	
12,500	×	½	6,250	
		6		55,750
		Total investment in month-dollars		$119,000

Card's share of the profit:

$$\frac{63{,}250}{119{,}000} \text{ of } \$5{,}000 = \$2{,}657.56$$

Folwell's share:

$$\frac{55{,}750}{119{,}000} \text{ of } \$5{,}000 = \$2{,}342.44$$

The first method will, of course, give identical results. The second method has this slight advantage that the "Investment Months" column will always total the same as the length of the fiscal period, provided each partner made his initial investment at the first of the period—which is not always the case—and acts as a check on the accuracy of that part of the calculation. This is a doubtful ad-

vantage, however, since accuracy is a prerequisite in all work of this kind and the first method is often the quicker and easier to operate.

Interest on Partners' Investments

A second problem of importance in connection with partnership accounting is the matter of allowing interest on partners' investments. The purpose of allowing such interest is twofold: First, it may serve as an indication of the excess of the profits in this enterprise over what might be obtained from the investment of a like amount in the money markets of the country, and, therefore, divides the profits into two parts, interest and management earnings; and, second, it may serve as a method of distributing profits up to a certain amount on the basis of capital investments, where the agreed-on ratio is different from the capital ratio and thus secure a distribution of the period's profits on two different bases or ratios. This is done sometimes to equalize somewhat the comparatively smaller-ratio profits of the partners who have made the larger investments. This problem, however, will be treated more fully in a later chapter where the methods of booking the interest, its treatment in case of a loss instead of a profit, and the computation of interest on drawings as well as on investments will be discussed and illustrated. Suffice it to say here that disputes frequently occur in connection with these problems and that detailed provision as to their handling should be made in the partnership agreement.

Valuation and Correct Booking of Original Investments

A third matter of importance is the valuation and correct booking of the original investments other than cash. In the case of the sole proprietor this is of comparatively little importance because he will always reap the entire gain and

therefore suffer no harm ultimately from present undervaluation of his property investments. In the partnership, however, where separate investment and personal accounts must be kept with each member, the matter of correct valuation of the properties invested is of importance inasmuch as these properties, as soon as they are invested in the partnership, become the joint property of all partners and all will share ultimately in the effect of any under- or overvaluation at the time of investment. The partners' accounts are set up for the purpose of showing their respective interests in the enterprise and after investments are once brought onto the books these accounts govern the equities of the various partners.

Distinction Between Buying Out an Interest and Making an Investment to Secure an Interest

The taking in of a partner by a sole proprietor or his admission as a new member to an existing partnership raises a point about which a very definite understanding must be had. A distinction must be made between purchasing from the owners an interest in the business as it stands at any given time and making an investment in a business in order to secure an interest in it. The first transaction is of a personal nature between the owners and a third party who is a purchaser; in the other transaction the third party, who is an investor, puts in money to acquire an interest and his investment becomes the common property of all the owners of whom he is now one. In the one case the capital of the business is not increased, in the other case it is increased by the amount of the new investment. For example, if a balance sheet shows:

Cash	$5,000.00	Liabilities	$6,000.00
Other Assets	15,000.00	A. Jackson, Capital	14,000.00

and Jackson sells a half-interest to B. Killian for a given consideration, the new balance sheet becomes:

Cash	$5,000.00	Liabilities	$6,000.00
Other Assets	15,000.00	A. Jackson, Capital	7,000.00
		B. Killian, Capital	7,000.00

In this case no new capital has come into the business because the purchase price does not go to the business as such but to A. Jackson as a private individual.

If, however, Killian is admitted as a half-interest partner by making a cash investment equal to the amount of Jackson's interest on the basis of book values, the balance sheet of Jackson and Killian will read:

Cash	$19,000.00	Liabilities	$6,000.00
Other Assets	15,000.00	A. Jackson, Capital	14,000.00
		B. Killian, Capital	14,000.00

showing an investment of double the capital of the original Jackson business.

The question of good-will which frequently comes up when an interest in a going business is secured will be treated in Chapter XLI, where also the manner of closing the books of the old business and opening those of the new firm will be shown.

Final Considerations

From the foregoing discussion it is evident that the partnership relation gives rise to some of the most vexing questions which confront the accountant and the lawyer. It is a truism, therefore, that in making the partnership agreement all eventualities should be foreseen as nearly as possible and that they should be carefully provided for. As a final safeguard it is well to provide for the submission to

arbitrators of disputes subsequently arising, the decision to be binding upon all the partners. This will avoid endless, expensive, and usually unsatisfactory actions at law and will more nearly secure justice to all. As a step in the same direction it is suggested that provision be made for the drawing up of correct balance sheets and profit and loss statements, that sufficient time be allowed each partner to examine them as to their correctness and, if satisfied, that each be compelled to subscribe to them. This will localize any dissatisfaction within a limited time period and secure its adjustment while all salient points are still fresh in the minds of the interested parties.

Practice Data*

(*Assignment for Chapter XXXIV*)

Summarized transactions for February were:

Purchases—Holland Gelatine Works, 2/5, n/30, $3,358.25; Kataguri Bros. 3/10, n/60, $2,054.75; Van Dusen Co., 8/5, 5/10, 2/30, n/90, $3,946.95; Delico Food Products Co., 5/5, n/30, $2,506.45; United Supply Co., 3/5, 2/20, n/30, $4,521.55; Federal Macaroni Co., 2/20, n/30, $334.05; Washburn Crosby Co. n/10, $5,568.30; cash purchases $155.82.

Sales—Casazza & Sons, 1/5, n/30, $1,942.67; Capella Bros., 2/5, n/60, $3,189.65; S. Brown, 3/10, n/30, $3,920.18; Four Corners General Store, 3/5, n/60, $4,682.40; Black Hills Mining Co., 1/10, n/30, $1,580.90; Blue Front Grocery, 2/5, n/20, $2,967.45; R. B. Kennan, 2/10, n/30, $3,852.75; J. Johnson, 1/5, n/60, $4,120.80; Bull's Eye Mining Co., n/10, $2,879.20; Badgley & Stewart, 1/5, n/30, $3,755.35; Dewey Brown, n/5, $1,925.47; Evans Sons, 2/10, n/30, $3,248.85; Fred Henry, 2/5, n/60, $3,869.68; cash sales $1,236.40; Gneisel drew groceries, $60.

Journal—Goods were returned by S. Brown $179.80, and R. B. Kennan $275.20, as unsatisfactory; made Four Corners General Store an allowance of $25 account of inferior goods; the January freight

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

bill, charged to In-Freight, was found upon analysis to contain freight paid on sales amounting to $29.87.

Cash Receipts—Stewart & Son, January bill $3,942.75 net; Jas. Butler, Inc., January bill $3,772.37 net; John Johnson, January bill $1,819.15 less 1%; Casazza & Sons, February bill $1,942.67 less 1%; S. Brown, balance of February bill $3,740.38 less 3%; Blue Front Grocery, February bill $2,967.45 less 2%; Badgley & Stewart, February bill $3,755.35 less 1%; Fred Henry, February bill $3,869.68 less 2%; cash was over $2.25; Jackson's note for $1,000 came due and was paid February 4; sold crating materials, $20.50.

Cash Disbursements—Grand Grocery, January bill $2,667 net; Holland Gelatine Works, February bill $3,358.25 less 2%; sales salaries $2,500; salesmen's railway mileage, entertainment, etc., $2,870.90; advertising $3,670.15; shipping clerks $750; paper, twine, wrapping supplies. $100.70; freight and drayage bills $750.80; rent for March $250; Kataguri Bros., February bill $2,054.75 less 3%; light and power bill $105.18; office salaries $500; Van Dusen Co., February bill $3,946.95 less 3%; board of horses, blacksmith, etc., $125.25; typewriter repairs $5; Delico Foods Products Co. February bill $2,506.45 less 5%; printer's bill for office supplies $72.80; watchman and janitor $85; gift to Red Cross $28.75; United Supply Co., February bill $4,521.55 less 3%; Federal Macaroni Co., February bill $334.05 less 2%; Ward drew $150; Cneisel, $125; cash was short $7.25.

Instructions

When the freight and drayage bills are paid, charge is made to In-Freight and Cartage. Subsequent analysis shows the amounts paid on sales to customers made f.o.b. destination. Journal entry is made once a month to correct the original charge.

Credit sales of crating material and other similar sales items to Miscellaneous Sales through the cash book only.

CHAPTER XXXV

HANDLING THE CASH

General Considerations

In keeping record of the various properties of a concern, the greatest care is usually exercised in accounting for the asset cash. This is done because of the difficulty in tracing money that is lost or stolen and the ease with which the thief may get rid of it, due to the universal use of money as a medium of exchange, and also because of its great value in comparison with its small bulk. Merchandise, supplies, and the like may be got away with but not so easily and profitably. Oftentimes, however, too little care is exercised in the safe-keeping of merchandise, and consequently in some lines of business real and large losses occur. Absolute prevention of losses cannot be expected even with the employment of all possible precautions, but experience shows that certain general safeguards should be placed about both cash and merchandise. After everything possible is done in the way of system, mechanical devices, and checks against the misappropriation of funds, in its ultimate analysis the best safeguard is the integrity of the employee. However, the employer who makes the abstraction of his cash an easy matter is guilty of tempting his employee to do a dishonest act.

Principle of the Double Record

A fundamental principle in the handling of the cash is to secure a double—not a duplicate—record of its receipt and disbursement. The practice of depositing in a bank

all cash receipts and making disbursements only by check secures this double record—the bank's record and the cashier's record. Any discrepancy is detected whenever comparison of the two records is made. Most concerns object to issuing checks for small amounts and set a minimum below which they refuse to issue them. For the purpose of paying these small amounts, a petty cash fund is provided from which disbursements are made in cash. This fund is established, in the first instance, by a check on the general cash and is replenished by check from time to time, and in this way double record is secured.

Handling the Petty Cash

Two general methods of handling the petty cash are met with. Under the one, entry of the check creating the fund is made as an immediate charge to some expense account and no further accounting is required. This method is based on the theory that it is to be used for petty expenses anyway, and might as well be so charged now as later. Subsequent amounts for replenishment of the petty cash are treated in the same way. The objection to this method, from the accounting viewpoint, is that it results in an inaccurate record of expense distribution and a misstatement of the facts in that it charges to expense an item which at the time of the charge is still a part of the general cash fund. The second and chief objection is that it encourages in the petty cashier loose methods in handling and accounting for the fund, as usually no strict reckoning is required.

The second method, known as the imprest method, is in more general favor. This charges the original check creating the fund to an account called "Petty Cash." The petty cashier is required to secure a receipted bill, sales ticket, or other voucher for every petty cash item of expenditure, so that at all times the amount of cash in his

possession added to the receipted bills and vouchers must equal the original amount in the fund. Usually the fund is a fixed amount, its size depending upon the needs of the business for these small expenditures. When the cash in the fund becomes low, the petty cashier turns over his receipted bills to the general cashier who issues a check for their exact total to replenish the petty cash by the amount of its depletion, thus restoring it to its original fixed amount. The expenditures as shown by the receipted bills and vouchers are classified and entered by either of the following methods: (1) as a charge to the several accounts through the general cash book, offsetting the petty cash replenishing check; in this case no charge ever appears in the "Petty Cash" account except the item covering the original check; or (2) entry is made through the journal debiting the various expense and other items and crediting Petty Cash. This necessitates charging in the general cash book the replenishing check to Petty Cash as an offset to the journal credit of the same amount. Most accountants consider the postings to the Petty Cash unnecessary—except the original—and so check both in cash book and journal. If, however, posting to the Petty Cash account in the general ledger is made whenever the fund is replenished, this would serve to indicate the activity of the fund on the face of the ledger account—information which could just as easily be obtained from the petty cash book. The imprest method thus effects a careful accounting of the petty expenditures.

The Petty Cash Book

The petty cash book is usually a columnar record with all the columns to the right of the explanation space. The first column on the left is the receipts column, the second the disbursements column, the others being distributive from

DATE			DR	CR	POSTAGE	SUPPLIES	OFFICE EXP.	ETC.	ETC.
1916 July	1	Check No. 51	100 00						
		Stamped Envelopes, cards		10 00	10 00				
	2	Sales Tickets		15 00		15 00			
	3	Window Cleaning, etc.		5 00			5 00		
	5	etc.		20 00			20 00		
	7	etc.		10 00	10 00				
	10	etc.		25 00	25 00				
		Totals		85 00	L 25 45 00	L 31 15 00	L 21 25 00		
		Balance down		15 00					
			100 00	100 00					
		Balance	15 00						
July	11	Check No. 125	85 00						

Petty Cash Book

the disbursements column under appropriate titles. Its form is somewhat as shown on page 292, with typical entries and balancing.

Sometimes the classified summary which is made the basis of the general cash book or journal entry referred to above is shown in the petty cash book, the account titles being written in the explanation column with the amounts opposite in the credit column underneath the $100 total. The items of this summary are then posted to the ledger, and the debit of the replenishing check to Petty Cash on the general cash book is "checked" in the ledger folio column. Or if the distributive column titles give sufficiently analyzed account titles, their totals may be posted without formal summarization, posting being shown by the small-figure ledger page in each column, as in the illustration. Where the petty cash book is used as a posting medium, of course, no summarization of it is made either in journal or general cash book.

Keeping the Bank Account

Several different methods of keeping the bank account are in use. Sometimes the check stub is the only record kept; in Chapter XXVI reference was made to the two methods of keeping the account on the stub. Provision is made either on the face or back of the stub for the entry of deposits. When made on the face, each check is usually subtracted from the previous balance and the new balance shown. When deposits are recorded on the back of the stub—or on a special deposits interleaf—check totals and deposit totals may be carried forward from leaf to leaf without showing any balance.

A better method is to use the stub only as a memo from which to make formal entry in the cash book where a bank column for deposits on the debit side and one for checks on the credit side are shown. These bank columns may be

used solely for the purpose of keeping the bank account, by showing the totals of deposits—but not the items composing each deposit—and the checks; and further, they may be used for the purpose of furnishing weekly or monthly totals for posting to a ledger account kept with the bank, thus making the ledger self-balancing without having to bring in the cash book balance. If, however, the principle of double record, explained early in the chapter, is followed, there is no need of a *special* bank deposits column since the total of the "Net Cash" column gives the amount of each day's deposits, and on the credit side similarly the "Net Cash" column shows the checks drawn against the bank. Thus the policy of depositing all receipts and disbursing only by check has an added advantage in that it simplifies the keeping of the record of cash as well as proving it. Under this method, the cash journals may be summarized, just as the other journals, and posted to a Cash account in the ledger. Detailed instructions for the handling of the entries, balancing, and closing under this method are given in Chapter XLVII.

A rather unusual method is sometimes met with, where a "Currency" column is carried on each side of the cash book, supplemented by "Bank" columns for deposits and checks on the debit and credit sides respectively. In the debit "Currency" column are entered all receipts of money in regular course. When the bank deposit is made up, its amount is entered as a charge to the bank in the credit "Currency" column and also, as a memo, it is entered in the debit "Bank" column. All checks as drawn are entered in the credit "Bank" column. Thus it will be seen that the balance of the "Currency" columns should show the actual amount of cash in the cash drawer at any time, and the difference between the "Bank" columns should show the balance in the bank. Though somewhat complicated, the method may under certain conditions give good results.

Of course, under all methods of keeping the cash record, the requirement that all cash received be deposited and payment be made only by check should be strictly adhered to.

Entering Checks on the Cash Book

When all disbursements are by check, every check drawn must be entered on the cash book and accounted for. Entry should be made in numerical sequence, any spoiled checks being entered with suitable explanation in this sequence, with the amount left blank or entered as usual, but in the latter case the amount of the spoiled check must also be included in that day's deposits, and the bank's cancellation stamp must be secured. Neither the deposit nor disbursement is posted, each entry being marked "contra" by way of explanation. This effects an inflation of the total receipts and disbursements, but, inasmuch as the bank's record shows it also, adequate check is secured. The new check taking the place of the one spoiled is entered in regular order.

The method just discussed is perhaps the best way of recording the exchange of checks for cash. Sometimes a concern is asked to exchange its check for currency, the party making the request desiring to send the check through the mails or for other purpose. The entry is best made on both the debit and the credit side of the cash book with reference "contra" in each case, but neither entry need be posted. This makes the cash book record check against the bank record and shows the full history of the transaction. When we cash others' checks from our currency, or when we receive in payment of a debt a check of larger amount and return the difference in cash, no record need be made of it, as only the nature—not the amount—of the deposit for the day is changed and no disbursement is made which affects the bank account. When, however, we cannot make

change in currency and issue our check for it, record should be made, debit and credit, as above.

Branch Cash—The Working Fund

Frequently in the case of branches or of a factory located at a distance from the main office, cash working funds must be provided for current expenses. When the branch or factory keeps a separate set of books, the advances of the working fund must be charged to them and a careful audit of the way they handled this fund must be made periodically, just as would be done with an independent concern.

Another treatment of such money transfers is along the general lines of the imprest method above referred to for handling the petty cash. The original advance is charged to "Factory" or "Branch Cash," and deposited in the branch's local bank to the credit of the head office with privilege of use by the branch. The branch may draw checks against it, sending the head office the cancelled checks as supporting vouchers for their disbursements. These cancelled checks become the basis for the replenishing checks and also of the charges for branch expenditure on the head office books.

If the branch is a selling agency making sales for cash and on account, a modification would be necessary. Daily reports should be required from the branch. Its cash receipts should be deposited daily and a duplicate deposit ticket should be forwarded to the head office by the bank. The bank should be asked also to forward all cancelled checks. All collections on customers' accounts should be made from the head office. This would not prevent the abstraction of cash before deposit, but would place control or oversight of the bank cash account in the hands of the head office and secure a careful accounting of it.

Proper safeguards for the cash should always be pro-

vided. Some considerations relative thereto will be presented in Chapter LIII.

Practice Data*

(Assignment for Chapter XXXV)

Post completely and take a trial balance as of February 29. In making record of this and succeeding trial balances, to obviate the necessity of rewriting account titles, fold back the two money columns on page 23 so that they "face up" on page 24, thus providing four money columns. This shortened leaf may now be used for recording trial balances for February and March. Similarly with succeeding leaves.

*See Practice Data for Chapter XXXIV.

CHAPTER XXXVI

DISCOUNTS

Definition and Kinds

A discount is a deduction from a listed or named figure. The manufacturer and the wholesaler in making up the catalogues of their products for the trade, usually enter them therein at certain prices—called list prices—which are not selling prices, but are nominal amounts on which the sale price is based. This method contemplates a deduction from list price which is called "trade discount." The usual quotation of sale price is at so many per cent below list price.

Among practically all merchants, a very common practice is to bill goods to customers, allowing settlement on an optional basis. They may be billed "net," i.e., the amount shown in the invoice must be paid. Since there is a relationship between the time allowed for payment and the amount to be paid, most concerns have an established credit term, at the end of which time they expect full settlement of the account. For earlier payment they offer as an inducement a reduction in the amount to be paid. This is stated usually at so much per cent below the billed price, and is generally called "cash discount." The practice had its origin in conditions prevailing at the close of the Civil War when the risk on accounts even for short credit terms was very great.

Bankers when making loans usually deduct from the face of the loan the interest charge for the use of the money. This deduction is called "bank discount."

Merchants usually allow a deduction for the prepay-

ment of a customer's note, and this is called "commercial discount," to distinguish it from bank discount, although in their essentials the two kinds are identical; the only difference is that in the one case the bank buys another's note, while in the other case it is a transaction between two commercial houses, the one buying back its own note before it is legally due.

Accounting takes cognizance of these four kinds of discount, although trade discounts are very seldom met with on the books, the actual selling price and not the list price being entered.

In the case of cash discounts, if the merchant knew at the time of the sale, which optional basis of settlement would be chosen, he might record the transaction at a net figure on that basis without entering the discount portion. This would, of course, result in a varying figure at which sales were booked.

In the case of bank discount, the discount portion has to be booked in order to show the cost of the loan and to maintain the equilibrium between the two sides of the entry. The matter of bank discount and the reason for so handling it will be treated in detail under Chapter XXXVII, "Notes and Bills."

The Method and Purpose of Trade Discount

Trade discounts are so universally met with that an extended discussion will be of value to the student. As was stated above, a trade discount is a deduction from the list price and this method of quoting prices to the trade serves two purposes. The price listed in the catalogue can not be changed until a new catalogue is printed. It would not be practicable to print a new catalogue whenever a change in selling price is made. Instead of this, new discount sheets are published at a very small expense, when-

ever prices fluctuate and a change in the list market price must be made.

Another purpose served by the use of trade discounts is that of partial secrecy as to the real quotation, the catalogue telling nothing as to the real price, as the key is in the rate of discount allowed from that list. Thus a concern need not by the publication of its catalogue lay itself open to the underbidding of competitors publishing later catalogues.

Prices may be quoted at a single discount or by means of a series of discounts, each taking as its base the net amount left after deducting the previous discount. Examples will illustrate:

1. Goods listed at $250 are quoted at 20% off. The sale price here is $200.

2. Goods listed at $500 are quoted at 50% and 20% off.
   50% off $500 leaves $250
   20% " 250 " 200—the same real sale price as in No. 1.

3. Goods listed at $750 are priced at 50%, 33⅓%, and 20% off.
   50% off $750 leaves $375
   33⅓% " 375 " 250
   20% " 250 " 200—the same as in Nos. 1 and 2.

Thus different *list* prices tell nothing as to *real* price, the trade discount being the determining factor.

Methods of Calculation

Short methods for calculating the discounts when given in a series are often employed. For a discount series of only two discounts, a single rate equivalent to the two in

the series may be found by subtracting the product of the two discounts from their sum—always treating the discounts as decimals. Thus a series of 20 and 20 is equivalent to a single rate of 36. (.20 + .20 = .40; .20 × .20 = .04; .40 — .04 = .36)

Another method, and one applicable to a series of any number of discounts, is to treat the discount off as equivalent to one-minus-the-discount on. Thus a discount of 15% is equivalent to 85% of the list. An additional discount of 10% would be equivalent to 90% of the new base, or 90% of 85% of the original list or 76.5%. Thus a continued multiplication of the "percentages on" gives the single sale-price multiplier to be used on the list price base. If the single discount rate is desired, this multiplier subtracted from 1 or 100% gives it. Take the series 60, 20, 10, and 10% off. This is equivalent to 40, 80, 90, and 90 on or 25.92% on (.40 × .80 × .90 × .90=.2592). The single discount rate equivalent to the series is, therefore, 74.08% (100%—25.92%=74.08%).

From the above discussion, it is evident that the *order* in which the discounts of a series are used is immaterial as the order of the factors does not affect the product.

The method just illustrated develops the reason for the special rule stated first above for the two-discounts series. Let the discounts be "a"% and "b"%. This is equivalent to (1—a)% and (1—b)%. Their product, algebraically, is 1— [(a+b)—ab], which is the "percentage on"; from which it is readily seen that the single-rate discount is a + b — ab, i.e., the sum minus the product of the two rates. Similar rules can be developed for longer series, but they are too complicated for easy application.

To illustrate the long and short methods, take this example: A list price of $875 with a discount offering of 25, 10. 10 and 5. To find the sale price:

(1) The long method:		(2) The short method:
		.75 × .90 × .90 × .95
875		.75
.75	.90 × 90 =	.81
4375		75
6125		600
656.25		.6075
.90		.95
590.625		30375
.90		54675
531.56	Equivalent single rate	.577125
.95		875
26 5780		2 885625
478 404		40 39875
		461 7000
504.98 net sale price		
		504.98

From the above examples it is seen that, after all, there is little choice between the two methods. There is the same number of multiplications in each and, unless the percentages are easy products and the list is a large number, there is practically no shortening through use of the second method, when applied to any one calculation. However, for comparative purposes, to indicate which of two discount series is the more favorable, the second method is far simpler and quicker. Also, the short method has a great advantage over the long method when a large number of

selling prices must be computed, all having the same series discount. This is true especially when the work is done with the use of a calculating machine.

The Nature of Cash Discount—Its Basic Elements

In the case of cash discount, two factors enter into the determination of the invoice or billing price. There is a direct relationship between the credit period and the loss from bad debts. Thus, if a credit period of 30 days results in a given volume of bad debts, an extension of the credit term to 60 days would undoubtedly result in an increased loss from uncollectible accounts, assuming that all factors, such as investigation of the risk, credit supervision, collection effort, etc., remain the same. Inasmuch as sale price must be sufficiently high to provide for loss from bad debts, the credit term has its effect in the determination of that sale price.

The other factor is the interest factor, a charge additional to the sale price on a cash basis, to cover the cost of being deprived of the use of the capital tied up in outstanding accounts.

Thus, when an optional settlement basis is offered, normally the controlling factors are the risk or cost of insurance against loss from bad debts and the interest cost. This is so under normal conditions, although special circumstances may make it expedient to offer other more or less favorable terms of settlement. Normally, terms of 2% off if paid within 10 days (2/10, n/30), the billed price being on a 30-day credit period, have this significance: the 2% measures two things: (1) the saving secured through receipt of the money 20 days earlier, and (2) a saving in the item of bad debts expense brought about by a shortening of the term for which credit is extended, from 30 to 10 days.

Showing Cash Discount in the Trading Section

There has been, and is yet, quite a diversity of opinion among accountants as to the proper treatment of cash discounts in the profit and loss summary at the close of a period. Some maintain that the discount is a trading or selling item, and for this reason they show it in that section of the statement. Their theory is that discount on sales partakes somewhat of the nature of a trade discount, that the real selling price is, after all, what is got for a particular bill of goods.

If goods are billed at $1,000 and $980 is accepted as full settlement, the sale should be shown only at $980 on the books. At the time of offering an optional basis for settlement, however, the merchant does not know which basis will be accepted, and he therefore enters the sale on his books at the highest offer. Later, if the customer settles on a more favorable option and takes his discount, this is logically a deduction from sales. Likewise, if the discount is considered as a bait offered to secure customers, it should be treated as a selling cost. Consequently, on either of these two theories, cash discount would have to be shown in the trading section of the profit and loss statement, in the one case as a direct deduction from sales, in the other as a selling cost.

Correct Method of Showing Cash Discount

Other accountants maintain that cash discount is a financial management item; that a manager, in order to secure ready funds with which to take advantage of the discounts offered him on his own purchases, offers his customers sufficient inducement to secure the early and prompt payment of their bills. The difference between the saving on purchases payments and the cost of securing early payment on sales is the measure of the efficiency of such finan-

cial policy. While this element may enter in, it would seem not to give a fully satisfactory explanation of the practice.

If cash discount has been correctly analyzed as being composed of the two factors, interest and bad debts expense, there can be no question as to the place of its showing, both factors being financial or administrative items and they should be placed in that section of the profit and loss statement. This analysis is believed to offer the best explanation of cash discounts. In this work they will, therefore, be treated as financial management items.

Account Titles for Cash Discounts

In booking cash discounts, two accounts are used, one for the discounts on sales, the other for the discounts on purchases. Self-descriptive titles are Sales Discount and Purchases Discount, which seem better than Discounts Allowed and Discounts Received and other similar titles.

Methods of Booking Cash Discount

In Chapter XXI, "The Cash Journals," two methods of handling the cash discounts were shown and explained, and will not be repeated here except to indicate their nature. Sometimes four methods are used, as follows:

1. The net cash received is entered in the cash book and the discount is entered in the journal, as follows:

Cash book entry:

Cash	$98.00	
Customer		$98.00

Journal entry:

Sales Discount	$2.00	
Customer		$2.00

This method rests on the theory that the cash book should be reserved solely for cash items. The objection is the unnecessary work involved and the failure to make a complete record in one place of the whole transaction.

2. Entry is made only in the cash book—the gross amount of the bill as a cash receipt, the discount as a cash disbursement. Its showing is:

Cash	$100.00	
Customer		$100.00
Sales Discount	2.00	
Cash		2.00

The objection to this method is discussed in Chapter XXI.

3. Entry is made only in the cash book through the use of a non-cash discount column on the receipts side. This was fully explained and illustrated also in Chapter XXI. In the illustration given there this discount column was not used in finding the cash balance, because net cash columns were employed, thus making unnecessary the use of any other column to find the cash balance.

4. Entry is made as in No. 3 above, but the discount column is used in finding the cash balance. Where, as sometimes happens, the net cash column is omitted, the true receipts can be found only by *subtracting* the amount of the discount from the other column totals.

The closing summary for the columnar cash book showed one method of handling the discount column total (see Chapter XXI). While all other summary entries for the cash receipts are *credits,* the discount summary is a *debit.* Because of this fact, the discount total is sometimes shown on the disbursements side of the cash book among the summary entries of the other columns, in which case the word "contra" is written after the words "Sales Discount," showing that the amount has come from the discount column on

DR.		CASH							CASH				CR.
DATE 1916			L.F.	SUNDRY	CUSTOMERS	SALES DISCOUNT	DATE 1916			L.F.	SUNDRY	CREDITORS	PURCHASES DISCOUNT
Aug	10	Sales		1250 25			Aug	10	Salaries		100 00		
	11	A. B. Zuarles			50 00	2 50		11	Jackson Mfg. Co			500 00	10 00
	12	J. Arlington			100 00	3 00		12	Purchases		540 69		
		Wm. S. Rankin			75 00	1 50		14	Bascom Selling Corp'n			1000 00	20 00
	14	Sales		1520 40				15	Expense		25 40		
	15	Notes Receivable		100 00					Creditors		1500 00	1500 00	
		Interest & Discount		6 00					Sales Disc't Contra		7 00		30 00
		Customers		225 00	225 00				Balance		958 56		
		Purchases Disc't Contra		30 00		7 00							
				3131 65							3131 65		
Aug	16	Balance		958 56									

Discount Columns used for Cash Balance—Method No. 4

the opposite page. Similarly for the Purchases Discount. There is no advantage in this except to bring all summary debit postings on one side of the cash book and all credits on the other. Where the cash book is operated according to method No. 4, closing summaries would show as given on page 307, using columns for Customers, Sales Discount and Sundry on the debit side, and columns for Creditors, Purchases Discount and Sundry on the credit side. As there is no net cash column, the totals for Customers and Creditors are not all cash. To clear them of their non-cash elements, the discounts should be subtracted from their respective Customers' and Creditors' totals, and only the net brought over into the Sundry columns; or the subtraction can be effected by adding the discounts to the opposite side. However, the use of a Net Cash column simplifies the summarization of the cash book and should always be employed. Treatment No. 4 is shown only because it is sometimes encountered.

Securing Information as to Neglected Discounts

Some authors of texts on accounting have suggested the desirability of bringing before a manager or proprietor the cost of his failure to take advantage of discounts offered him. To show this cost for a purchase transaction, the following entry is made at time of purchase:

Purchases	$100.00	
Purchases Discount..................................	5.00	
Vendor		$105.00

the *net* amount of the bill being charged to Purchases, the best discount offering to Purchases Discount, and Vendor being credited with the billed amount gross. When payment is made on any of the optional bases offered, entry is made:

(1) Vendor	$105.00	
Cash		$105.00
or		
(2) Vendor	$105.00	
Cash		$103.00
Purchases Discount......................		2.00

In the case of No. 1, the net result of the whole purchase transaction would be a loss or expense of the amount in Purchases Discount through failure to take the discount. In No. 2, if the best option were taken, viz., the entire 5%, Purchases Discount would show no balance; any less favorable option, say 2%, would result in a debit balance in Purchases Discount of 3%, measuring the expense incurred through failure to take the best option. Unquestionably, the information given a manager by this Purchases Discount debit balance would claim his immediate notice and attention.

A sales transaction handled on a similar basis would result in a Sales Discount credit balance representing the excess of the offering of discounts over what is taken by customers and would have to be treated as income additional to the booked sales income.

Inasmuch as the sale or purchase, under this method, must be booked on a cash option basis, this treatment would seem to result in a departure from the fact of true cost or an inconsistency in booking *some* of the elements which enter into the cost of merchandise and not *others*. The price at which a merchant can sell his product must include all direct and indirect costs and provide a margin for profit. The Sales Discount offered is simply one of these indirect costs. It cannot be more accurately estimated than can the salesman's salary element which is a part of the sale price. It is not consistent to separate the invoice price into two elements and term one *real* selling price and the other sales discount cost when the "real" selling price is still a very

composite item. Rather, book the sale at its full invoiced price and record actual costs and apply them later as they accrue.

After all, the sales policy of each concern enters largely into the determination of its normal selling price. A concern with a normal credit term of 30 days fixes its sale price on that basis; one with a 60-day credit term will have its sale price fixed by the risk and interest costs, mentioned above, based on the 60-day term; and one doing a cash business will determine its sale price accordingly. However, in order that each concern may have the information necessary for its guidance under its particular sales policy, sales should be recorded on the basis of its normal credit term.

To secure the information sought as to neglected discounts, it is suggested that memorandum accounts be raised for that purpose and entry be made of the expense only when incurred. Thus, failure to take a purchases discount would be recorded under these or similar captions:

Neglected Discounts
    Reserve for Neglected Discounts

At the time the books are closed these memorandum accounts would be closed against each other, having served their purpose of giving the desired information through being included in the trial balance submitted to the manager or owner.

Trade Acceptances and Cash Discounts

Brief mention should perhaps be made of some recent discussions of the probable effect of the extended use of trade acceptances on the practice of allowing cash discounts. Some sellers to whom the cash discount practice is troublesome and unsatisfactory welcome the use of trade acceptance as an avenue of escape. Others have gone so far as to

say that the trade acceptance will eventually do away with the practice. It should be said that the use of trade acceptances, while very attractive from the seller's standpoint, has not yet made a strong appeal to buyers largely because of the fact that it offers little that the open account method does not secure for them and it may interfere somewhat with the taking of cash discounts.

Practice Data*

(*Assignment for Chapter XXXVI*)

Summarized transactions for March were:

Purchases—Swift & Co. 2/5, n/30, $3,431.65; Austin Nichols & Co., 5/5, n/30, $6,675; Grand Grocery, n/10, $3,821.95; Reid, Murdock Co., 3/5, 2/20, n/30, $7,384.60; Kataguri Bros., 3/10, n/60, $4,152.75; Washburn Crosby, n/10, $8,472.80; F. Mezzadri, 8/5, 5/10, 2/30, n/90, $4,625; cash purchases $580.19.

Sales—Fein Bros., n/5, $3,782.25; M. Heitzman, 3/10, n/30, $4,174.85; H. A. Krebs, 1/30, n/60, $1,279.45; Andrew Davey, 3/5, n/30, $2,854.20; Wm. Crick, 1/10, n/30, $1,915.15; Russo Bros., 2/10, n/30, $2,518.75; Progressive Stores Co., 3/5, n/20, $4,189.60; J. Perlman, 1/5, n/30, $3,650.70; P. Peterson, 2/5, n/60, $2,500; Uintah Copper Co., 3/10, n/30, $1,755.85; Circle Bar Ranch, 3/5, n/20, $2,189.60; J. R. Rice, 3/5, n/60, $1,954.25; Al Morton, 1/10, n/30, $4,520.67; J. J. Tommich 2/5, n/20, $3,979.98; Ward drew groceries, $30; cash sales $3,987.40.

Journal—Accepted Austin, Nichols & Co. 30-day sight draft due April 24 for their bill of March $6,675 less 5%; received goods returned by the Progressive Stores Co., $1,125.50; returned flour to Washburn Crosby $1,500; received 60-day 6% note, due May 20, from Dodts' Grocery for January bill $1,517.18; received goods from M. Heitzman, mistake in filling order, $1,000; out-freight for February was $80.19; received goods from Al Morton, inferior quality, $987.25; received 30-day 6% note, due April 26 from Four Corners General Store for balance of February bill $4,657.40 less 3%; cash shortage of February is partly accounted for by failure to book a payment of $5.25 for general window cleaning.

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

Cash Receipts—Capella Bros., February bill $3,189.65 less 2%; Black Hills Mining Co., February bill $1,580.90 net; R. B. Kennan, balance of February bill $3,577.55 less 2%; A. M. Scott's note $1,500 fell due on the 8th and was paid with interest; Dewey Brown, February bill $1,925.47 net; Evans Sons, February bill $3,248.85 less 2%; Fein Bros., March bill $3,782.25 net; M. Heitzman, balance of March bill $3,174.85 less 3%; Gristede Bros. note $2,790.85 fell due on the 28th and was paid with interest; Andrew Davey, March bill $2,854.20 less 3%; Progressive Stores Co., balance of March bill $3,064.10 less 3%; Circle Bar Ranch, March bill $2,189.60 less 3%; cash was over $1.25; J. R. Rice March bill $1,954.25 less 3%.

Cash Disbursements—Salesmen's salaries $3,600; salesmen's traveling expense $3,120.80; advertising expense $2,560.18; shipping clerk $900; Swift & Co., March bill $3,431.65 less 2%; F. Mezzadri, March bill $4,625 less 8%; shipping supplies cost $240.25; freight and drayage bills were $890.20; rent for April $250; insurance, 1 year policy, March 1, 1917 to March 1, 1918, $240; extra help in shipping room, wagon repairs, etc., $190.50; Reid Murdock Co., March bill $7,384.60 less 3%; coal, power, and light bills $127.80; office salaries $575; office expense $7.80; stamps, etc., $58.20; Kataguri Bros., March bill $4,152.75 less 3%; bought office safe $250, and paid freight on same $28.30; gift to church bazaar $30.25; 1 year's membership, March 31, 1917 to March 31, 1918, in credit men's association $50; Washburn Crosby bill for February, $5,568.30 net; cash was short $18.40; Ward drew $500; Gneisel $125.

Instructions

Notice that the cash shortage recorded for February resulted from the failure to enter an expense item for window cleaning. This is discovered in March and should be corrected by journal entry debiting General Expense and crediting Cash Short and Over, giving adequate explanation.

CHAPTER XXXVII

NOTES RECEIVABLE AND PAYABLE

Conditions Precedent to the Present Use of Notes and Bills

During the twelfth and thirteenth centuries there was much bad money in circulation in Europe, due to the machinations of coin shavers and an entire lack of standards of purity for the coins of any country. If a monarch needed more revenue to carry on wars or run his government, the easiest way was to increase the amount of base alloy in the coins of the country or to increase the rate of seigniorage. As the former method might be resorted to several times during the reign of one sovereign, the result would naturally be to place all metallic coins under suspicion, their weight and relative purity having no relation to their denominated value. Consequently, it was only the money dealers, those who could determine the actual value of coins by assaying, who were willing to trade for coins. These men gradually became the custodians of moneys for merchants and in return for the money thus received in custody they handed to the merchant a receipt giving the assay value of the coins deposited. This receipt, because it represented tested and proven value, soon became a more acceptable medium of exchange than the coins themselves.

This is supposed to be the way in which paper money came into use in Europe during that period. Mediæval trade was subject to many perils, chief among which was that from robbers. Any safeguards that might be placed about the transportation of money from one place to another, or methods devised for settling debts without the

transportation of coin and bullion, were more than welcome. Arising out of these conditions came the method of settling debts by means of drafts. Not countenanced by law at first, the "law merchant" soon became recognized as a code of rules governing commercial relations, and was later incorporated by statute into the law of the country. These two kinds of paper, the one being in the nature of a demand promise to pay, the other a counterpart of the modern draft, were the forerunners of our promissory notes and bills of exchange of the present day. The law with regard to the bill or draft became settled from the practice of merchants before that relating to notes.

The Titles "Notes" and "Bills"

In this way, the word bill became an established term. The titles "bills receivable" and "bills payable" still cling to both classes of items. Inasmuch as the accepted bill is practically identical with the promissory note, and the title "bill" is so often used interchangeably with the word "invoice," it is advisable to use the terms notes receivable and notes payable instead of bills receivable and bills payable. Some advocate the use of the title "acceptances" in order to distinguish accepted bills from promissory notes; but to one who understands the nature of the two instruments, there is no advantage, either as to clearness or as to practice, in the use of the suggested title. The drawer of an accepted draft becomes the first guarantor or indorser on it and, under the theory of contingent liability discussed later, the accepted draft should receive additional treatment when notice of acceptance is received.

Relation of the Note to the Open Account

In Chapter XXIV, a preliminary discussion was given of the relation of the note to the open account. It was

pointed out that both are claims against the person liable for payment, but the one is carried under a class title "Notes Receivable," because the number of such notes is usually small, while each account receivable is carried under a separate title which designates the person liable for payment. The essential difference between the two kinds of claims is that the note is looked upon as being in itself an acknowledgment of the justice of the claim and the correctness of the amount, whereas the claim under the open account is subject to dispute, and in case of dispute requires outside proof; besides, the open account may always be offset by counter claims and sometimes by a return of all or a part of the goods bought.

As between the original parties to a note, any defenses of value under the contract for which the note was given, are good defenses under the note; but not so as between the maker and a third party who is an innocent purchaser for value. To him the maker is liable according to the exact terms and tenor of the note. Only so could the element of negotiability be insured and the note pass from hand to hand as money. In no other sense is the note a preferred claim over the open account.

In case of bankruptcy a claim against the bankrupt under an open account and a claim under a promissory note or an acceptance made by the bankrupt before his insolvency, rank alike, both sharing pro rata in the net assets available for the satisfaction of the total claim of unsecured creditors.

Relative Liquidity of the Note and Open Account

Compared with open accounts as to their relative liquidity, promissory notes have a slight advantage in that they can more readily be turned into cash and at a better rate. Under present conditions, although assignment of open accounts is possible, the basis is almost prohibitive,

whereas the legitimacy and the low cost of discounting notes greatly increase their liquidity. Oftentimes the question of risk, i.e., the degree of certainty of their payment when due, enters into the determination of the relative liquidity as between open accounts and promissory notes, but from this standpoint there is little, if any, difference between the two claims. Occasionally, a firm which refuses to pay its debts on open account, will meet its notes and acceptances in an effort to bolster its credit at the local banks. This phase of the question does not usually enter into the discounting operation, where the credit of the discounter is the determining factor in raising money. Of course, this may be only a temporary expedient if the note is dishonored and charged back by the bank. However, the note is usually classed as a more liquid asset than the open account

Method of Recording Notes

As to the accounting phase of the subject, a careful record is made of each note as it is received or given, entry being as a note receivable or payable according as we are not or are the maker of it and therefore are not or are liable for its payment when due. If the note transactions are few in number, the general journal is used for their record. Ample explanation must be given as to the essential facts of date, maker, for what received, rate of interest, due date, etc. Notes receivable must be watched carefully, as failure to present them when due releases all indorsers. There is nothing unusual in the entry when made in the journal, its debit and credit being determined as indicated in Chapter XII.

The Note Journals

Because the Journal does not lend itself to an easy record of the essential data pertaining to note transactions,

oftentimes a separate book is kept for this purpose. This subsidiary book may be used merely as a memorandum record for carrying the detailed explanation of the journal entry, or it may become a subsidiary journal used as an integral part of the accounting system, and, when so used, posting to the ledgers is made direct therefrom. The use of this subsidiary journal is always advisable when note transactions are numerous. A bill or note journal often carries rulings as shown on page 318.

The notes payable journal differs but slightly. If the bill book is for memorandum only, the "Amounts Credited" columns may be omitted. If it is a real note *journal,* its debit and credit equilibrium is shown through summary entries at posting time. The total debit is to Notes Receivable for the amount of that column's total. If it were not for the fact that sometimes notes are received in whose face amount is included not only the credit to the customer, but an interest item as well, there would be no need of credit columns. The note journal would then be operated on the same principle as the sales journal with a debit to Notes Receivable, the same amount being used in crediting the customer; but interest being included, treatment is best secured through an additional column, separating the credit to Customers from that to Interest. If notes are numerous, it might be well to use a distributive column in the cash book for receipts from notes and secure a total posting to the credit of the account as well as to its debit through the note journal. This is a matter for determination in individual cases, and no general rule can be laid down.

Referring to the left-hand page of the illustrated ruling, the face amount of the note receivable is entered in the "Notes Receivable" column, and the due date is entered in one of the narrow columns headed "When Due," each of these columns representing a separate month. In this

NOTES RECEIVABLE

DATE RECEIVED	DATE ISSUED	NO.	FROM WHOM RECEIVED	AMOUNTS CREDITED				DEBIT		WHEN DUE													TIME		RATE %
				Customer	L.F.	Interest	L.F.	Notes Receivable	L.F.	Year	J	F	M	A	My	J	Jy	A	S	O	N	D	Mo.	Da.	

NOTES RECEIVABLE

MAKER	PAYEE	INDORSERS	WHERE PAYABLE	FOR WHAT RECEIVED	HOW DISPOSED					
					Date	Amount Collected	Date	Amount Discounted	Interest & Discount	

Notes Receivable Journal (left and right-hand pages)

way it is easy to find the total of all the notes due in a given month and the amount of cash to be expected from that source.

Where desired, the note journal may be arranged on the principle of a "tickler" by *months*. One page is reserved for each month, and the notes are entered on the proper page in chronological order, thus showing month and day on which they fall due. A recapitulation would be necessary to secure one total for posting all notes received during each month, since the method described distributes the notes over separate pages according to due date and so does not show in any one place the total notes received each month. Therefore, at the end of each month, the various month pages should be totaled and "recapped" on a special page for recapitulations, or on the page assigned to that particular month for which the total receipts of notes are wanted. The separate recapitulation page specially ruled for the purpose would, however, seem better.

Notes Entered at Face Value Always

Some notes are interest-bearing from their date of issue; others, only after their due date if not then paid. Even on non-interest-bearing notes, the law allows the charging of interest for their overdue period. From the standpoint of strict accuracy, a note payable at a future time is not worth its face value at the time of entry, unless it is interest-bearing from date at approximately as high a rate as the current discount rate. Its present value is such an amount as placed on interest would equal the face at its due date. Its value increases day by day until it reaches par or face on the due date. Because of the practical difficulties encountered in the numerous adjustments necessary under any other method of entry, universal practice countenances the bringing of the note onto the books at a slightly inflated value, i.e., face

value, at the time of entry. Face value is the basis for credit to the customer, shows the amount to be collected on account of the note, and, if interest-bearing, the amount on which the interest is based. Accordingly, the note transaction is entered at its face value. Where the note is interest-bearing and the face plus the interest is paid at maturity, credit is in two items, one to Notes Receivable for the face and the other to Interest or Interest and Discount for the amount received as interest.

Occasionally, the interest is figured on the amount of the debt for the period the note is to run and added to the amount of the debt. This is made the face of a non-interest-bearing note. The end aimed at by such a procedure is to secure a compounding of interest for the first period if the note is not paid at maturity. Its entry on the books is a debit to Notes Receivable for the face of the note and credits to the customer for the amount of the debt and to Interest and Discount for the amount of the pre-estimated interest; with only a credit to Notes Receivable when the note is paid. This credit to Interest and Discount, before the interest is actually received, is necessitated by its pre-estimate and inclusion in the face of the note.

The Interest Accounts

Oftentimes two interest accounts are carried on the ledger, one for Interest Income and one for Interest Expense. This, of course, secures analysis under those heads and is the best way when the items are numerous. Sometimes just the one account, Interest and Discount, is carried. If it is desirable to separate the two classes of interest, it may be done by entering the debit and credit totals of the Interest and Discount account—instead of simply the balance—when the trial balance is taken. It is perhaps needless to say that bank discount—interest paid in advance—is the only kind

of discount recorded under this account title and must not be confused with the discounts on sales and purchases.

Practice Data*

(*Assignment for Chapter XXXVII*)

Post completely and take a trial balance as of March 31.

*See Practice Data for Chapter XXXVI.

CHAPTER XXXVIII

PROBLEMS ENCOUNTERED IN RECORDING NOTES RECEIVABLE AND PAYABLE

Entries in the Account

The subject of entries to the note accounts has been treated in Chapter XV and will be reviewed and summarized here.

First, where the Notes Receivable account in the ledger shows the receipt of each note as a separate item rather than by totals, good practice countenances the recording of the *credits* in this account in non-chronologic order. Usually, postings on both sides of any account are made according to the chronology of the transactions; the Notes Receivable and the Notes Payable accounts, however, form an exception to this general rule. For instance, when a customer settles his promissory note and consequently the document is returned to him, the credit to Notes Receivable should be so entered that it appears exactly opposite the original debit item. This brings each complete note transaction on one line and shows at a glance which notes are outstanding, as evidenced by the blank lines on the credit side of the account.

When, on the other hand, the credit items are entered in chronological order, the same purpose is accomplished by the use of an index figure for the original debit and the corresponding credit item. The first method, which disregards the chronological order, is to be preferred, because the results are shown more plainly than by the use of index figures.

What has been said in the preceding paragraphs concerning notes receivable applies also to notes payable.

The Discounted Note

A second point, referred to in Chapter XII, concerns itself with the booking of notes receivable discounted and accepted drafts. The problem here arises from the legal right accorded the holders of notes, in case of non-payment by the maker, to look for payment to any or all of the indorsers, provided certain formal requirements are complied with. For this reason, whenever a business house transfers a note by any method of indorsement (except the qualified), it incurs a *contingent liability,* which might become a real liability in case the maker of the note should fail to meet the obligation at maturity. Since it is the function of good accounting to present *all* the facts bearing on the welfare of the business, it is evident that this fact—that of incurring a contingent liability—should be entered in the books of account. Very frequently, however, the importance of this matter is practically ignored, with the result that the contingent liability item is lost sight of altogether. The usual, though incorrect, method of journalizing a note discounted transaction is as follows:

Cash
Interest and Discount
    Notes Receivable

showing that the note has passed out of our hands and that the amount of its face value minus the discount has been received by us. This would be correct and all that is needed, were it not for the legal condition attaching to all such sales. Accordingly, for the purpose of showing the complete facts, the entry at the time of discount should be made as follows:

Cash
Interest and Discount
Notes Receivable Discounted

and at maturity, when the note is paid by the maker:

Notes Receivable Discounted
Notes Receivable

The effect of the first entry is to set up a suspense account, Notes Receivable Discounted, representing our contingent liability. The effect of the second entry is, first, to cancel the *credit* of the Notes Receivable Discounted account because upon payment of the note by the maker our contingent liability ceases to exist, and, second, to cancel the original *debit* to the Notes Receivable account which was made at the time the promissory note was received but remained *unchanged* when the note was discounted because it was still needed to record the contingent asset which would come back into our possession in case the contingent liability became a real liability.

Some authors have argued that the above treatment stretches the theory of debit and credit nearly to the breaking point. It must be observed, however, that the practical ends to be obtained are of more importance than any preconceived theories, and, whenever good practice grows faster than the corresponding theory, it is the theory that must be changed to fit the practice.

It would be incorrect, however, to regard Notes Receivable Discounted as an independent liability account, because it only represents a contingent liability. The two accounts Notes Receivable and Notes Discounted must be considered together, the latter account being set up merely for the purpose of keeping notes discounted under review until their final status is determined. The purpose of the

Notes Discounted account is in a way similar to that of the valuation accounts of depreciating assets. The asset account is held at its original figure and, in order to determine the present value of the asset, the valuation account must be referred to. So with notes. The asset account, Notes Receivable, is held at its original figure, even though some or all of them may be discounted; and in order to know the amount of notes receivable actually on hand, the credit of the Notes Discounted account must be subtracted from the debit of the Notes Receivable account. Under this theory Notes Receivable Discounted would not be shown in the balance sheet as a liability item, but would appear as a deduction from its dominating or correspondent account, Notes Receivable, extending among the assets only the amount of notes now actually in our possession. It should be remarked, however, that there is a growing tendency to show this contingent liability on the liability side of the balance sheet, separating the corresponding asset into two items, the one Notes on Hand, the other Notes under Discount per contra. Banks follow this practice in showing trade acceptances.

At maturity of the note the final entry (Notes Receivable Discounted debit and Notes Receivable credit) is placed upon the books as illustrated above. Usually no formal notice is received by the indorser that the note was paid by the maker. In case the note is dishonored, prompt notice would be sent and failure to receive such notice implies that the note was duly paid.

What has been said in the preceding paragraphs concerning notes applies with equal force to accepted drafts, for the reason that the legal character of the latter is identical with that of notes, and the status of the drawer of an accepted draft is the same as that of the first indorser of a promissory note.

If A draws a draft on B in favor of C for $100, the customary, although theoretically incorrect, entry on A's books is as follows:

C	$100.00	
B		$100.00

Following the theory just developed, a more accurate and fuller showing on A's books would be secured by dividing the transaction into three elements and treating each element separately, as follows:

1. The acceptance of the draft by B:

Notes Receivable.....................................	$100.00	
B		$100.00

2. The receipt by C of this accepted draft:

C	$100.00	
Notes Receivable Discounted..................		$100.00

3. The payment by B at maturity:

Notes Receivable Discounted..........................	$100.00	
Notes Receivable..............................		$100.00

By following this method the books would show the correct status of the transaction at any point of its development. Before maturity of the draft the credit to Notes Receivable Discounted acts as an offset to the Notes Receivable debit, at the same time indicating the contingent liability attached to this draft. At maturity, when C collects the amount from B (the drawee), the contingent liability ceases to exist, and Notes Discounted is therefore debited. The corresponding credit is to Notes Receivable in order to cancel the original debit item, as shown in the first entry given above.

Before leaving this subject it may be well to remark that in many instances there may be good practical reasons for not adhering to the above principles. When for instance a large number of notes and acceptances are handled and the experience of the business shows that practically none of them are ever dishonored, or if the matter is under close view by the financial manager, it might be considered an unnecessary loss of time and effort to make the additional entries incident to a separate Notes Receivable Discounted account. It must be left to the judgment of the accountant to decide which method is preferable in connection with the needs of the business. However, in case no current account is kept to show the contingent liability, it may be well at the end of the period to make an adjustment entry to show the amount of notes discounted still outstanding as of the closing date of the period.

The Dishonored Note

A third problem arises in case a note is dishonored by the maker. A note is dishonored either when the maker refuses payment upon its legal presentation at maturity or upon sufficient evidence that the maker intends to refuse payment when due. When a note has been dishonored, a formal protest is required in order to hold the indorsers. The payee appears before a notary public or other officer with notarial powers and makes oath that legal presentment of the note has been made and that the payment was refused. The notary then takes the note and personally presents it for payment to the maker. If payment is still refused, the notary makes a certificate of protest and mails notices of the protest to all indorsers desired to be held. Such notice is sufficient as a basis for action to recover from the party or parties thus notified.

In making the accounting record a number of problems

may arise in connection with dishonored notes. These problems deal with the situation, (1) when the note is dishonored in the hands of the named payee, and (2) when the note has been discounted by him and is charged back on account of dishonor. The discussion will be directed to the following two cases:

Case 1. Promissory note made by P. Canning for $100. Payee, D. Johnson. Due December 15, 1916. At maturity Johnson presents the note for payment, but payment is refused.

Case 2. Promissory note for $250 made by P. Canning. Payee, D. Johnson. Due December 15, 1916. Note was discounted by Johnson. Final holder is A. Andrews who presents the note for payment on December 15, 1916, but payment is refused.

The questions arising may be stated as follows: What record should be made on December 15, 1916—

(a) By D. Johnson in Case 1.
(b) By A. Andrews in Case 2.
(c) By D. Johnson in Case 2.

(a) D. Johnson at the time he received the note from Canning made the following entry:

Notes Receivable....................................	$100.00	
P. Canning....................................		$100.00

and on December 15, in order to show that the note is dishonored he may make either of the following two entries:

(1) P. Canning....................................	$100.00	
Notes Receivable..........................		$100.00

or

(2) Notes Receivable Dishonored..................	$100.00	
Notes Receivable..........................		$100.00

Entry (1) takes the charge out of the note account and sets it up again as a claim on Canning's open account. Entry (2) transfers the charge to a Notes Receivable Dishonored account. Entry (2) is theoretically a better entry than entry (1) because from the latter it might be inferred that the nature of the claim has changed from a note claim to an open account claim. Such change has not taken place, however; Johnson's claim against Canning is still under the note. Therefore, entry (1) is not true to the facts.

On the other hand entry (1) has an important advantage over entry (2) because by posting entry (1) Canning's personal account in the ledger will show the fact that one of his promissory notes was dishonored. This is a matter of very great importance, especially with reference to future credit ratings of Canning's account.

If the second method is adopted it is clear that by merely posting the entry the fact of dishonor will not be shown on Canning's account. It is essential, therefore, that the bookkeeper should make a special memo on the face of Canning's account. This would be satisfactory if the bookkeeper could be absolutely depended upon to make such memorandum entry. Any treatment consistent with accounting principles and securing a complete history in one place of all our dealings with the individual, will satisfy all requirements.

(b) A. Andrews, who is the last indorsee of the note, at the time the note is dishonored should make the following entry:

Notes Receivable Dishonored........................	$250.00	
Notes Receivable..............................		$250.00

The Notes Receivable Dishonored account represents Andrews' claim against any or all of the indorsers whom he

wishes to hold responsible. Instead of this, an entry might be made corresponding to entry (1) discussed above.

(c) In case the note should be charged back to Johnson, either by Andrews or by any one of the other indorsers, he should make the following entries:

Notes Receivable Discounted	$250.00	
Cash		$250.00
P. Canning (or Notes Receivable Dishonored)	$250.00	
Notes Receivable		$250.00

It will be noted that these two entries will completely reverse the two original entries made by Johnson, viz.:

Notes Receivable	$250.00	
P. Canning		$250.00

at the time he received the promissory note from Canning. and

Cash	$250.00	
Notes Receivable Discounted		$250.00

when he transferred the note by indorsement.

Of course, it is to be understood that all expenses in connection with the dishonored note should be charged either to the personal account of the maker or to the Notes Receivable Dishonored account, as the case may be.

Where the Notes Receivable Dishonored account is used, it secures a good analysis of the claims against customers from the standpoint of probable realization and gives a relatively better basis for the bad debts estimate than that offered by the other manner of treatment. Of course, the use of such an account would be limited to the ledger; it would never appear as such on the balance sheet, being there included with the customers' accounts with ample reserve for uncollectible items.

The Classification of Notes

A fourth problem in connection with notes deals with their proper classification. The Notes Receivable account should carry only the short-time notes of customers, making it a truly current asset. On the other hand, all long-time notes and those secured by mortgage should be booked under another account title in order not to be confused with the short-time, liquid, or soon-to-be converted notes. For a similar reason, the notes receivable given by officers, employees, or stockholders of a loosely managed corporation should have separate booking, as these are more usually given for the purpose of making formal record and acknowledgment of indebtedness without regard to time of payment. Since such notes usually do not constitute easily convertible assets they should not be recorded under the same account with short-time customers' notes.

Notes Receivable Out as Collateral

Notes receivable are sometimes given as collateral security for a loan. When so used, no accounting problem is involved—though a memorandum to show their use as such should appear in the note account. However, if these notes are sold to satisfy the loan, this would constitute a regular business transaction, which should be recorded in the proper manner.

Note Renewals and Partial Payments

The renewal of notes and partial payments are other features met in the accounting for notes. The renewal of a note is rather a question of business policy than of accounting procedure. When a note is renewed, it is better to deliver up the old note and secure a new one in its stead. If the new note is of the same tenor as the old one, no separate posting of it is absolutely required, except to

indicate, in the explanation space, that it is a renewal. However, this would necessitate also a change in the original entry in the journal, and to avoid this it would be preferable to reverse the old entry and enter the renewal separately.

From the financial standpoint, if neither note is interest-bearing, the amount of the renewal note should be larger than that of the old note to cover the cost of deferring payment to a future date. For example, if the old note amounts to $1,000 and is renewed two months later, the amount of the new note should be fixed at $1,000 plus 1% interest, or $1,010.

In the case of partial payments, no new accounting principle is involved; however, when partial payments are numerous, additional space in the note journal and in the ledger should be provided for the purpose of facilitating the actual work of making the book record.

Practice Data*

(*Assignment for Chapter XXXVIII*)

Summarized transactions for April were:

Purchases—Reid Murdock Co., 3/5, 2/20, n/30, $8,954; Armour Packing Co., 2/20, n/30, $6,256.55; Korn Products Co., 3/10, n/60; $5,820.20; Holland Gelatine Works, 2/5, n/30, $7,778.90; Van Dusen Co., 8/5, 5/10, 2/30, n/90, $9,825.35; United Supply Co., 3/5, 2/20, n/30, $8,703.15; cash purchases $1,767.49.

Sales—J. Henry Witt, 2/10, n/30, $3,000; U. B. Zipkin, 1/5, n/60, $4,190.15; Las Vegas Cattle Co., 3/5, n/20, $2,150; Quinn Bros., n/10, $3,975.20; Stewart & Son, 1/5, n/30, $4,005.35; S. Koenig, 2/10, n/30, $2,875.45; M. E. Dietrich, 2/5, n/60, $4,150.60; Jas. Butler, Inc., n/5, $5,152.75; C. A. Gerken, 3/10, n/30, $2,875.60; John Johnson, 1/30, n/60, $3,105.20; Jacob Green, 3/5, n/30, $2,900; Bull's Eye Mining Co., n/10, $3,219.65; Badgley & Stewart, 1/5, n/30, $2,850.70; Dewey Brown,

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

n/5, $3,390.79; Evans Sons, 2/10, n/30, $2,760.46; Andrew Davey, 3/5, n/30, $3,840.90; Black Hills Mining Co., 1/10, n/30, $2,160.50; cash sales, $5,189.62; Gneisel drew groceries $90; R. B. Kennan, 2/10, n/30, $3,140.65.

Journal—transferred office cash register to cash sales department of store, $125; returned canned goods to Austin, Nichols & Co., $350, adjustment to be made at the time of paying their draft; received goods returned by U. B. Zipkin as unsatisfactory $875.50; received 60-day 6% note, due June 10, from M. J. Downing for January bill $1,680.40; received spoiled goods returned by Stewart & Son, of their April purchase, $1,250; out-freight for March was $100.25; received goods of April bill returned by Jas. Butler, Inc., error in filling order, $1,580.20.

Cash Receipts—R. B. Kennan, April bill, $3,140.65 less 2%; J. Johnson February bill, $4,120.80 net; Bull's Eye Mining Co., February bill, $2,879.20 net; Badgley & Stewart, April bill, $2,850.70 less 1%; Dewey Brown, April bill, $3,390.79 net; Four Corners General Store note for $4,517.68 came due on the 26th and was paid with interest; H. A. Krebs, March bill, $1,279.45 less 1%; Wm. Crick, March bill, $1,915.15 net; Russo Bros. March bill, $2,518.75 less 2%; J. Perlman, March bill, $3,650.70 less 1%; received refund of $75.80 from railroad for overcharges on freight bills already paid; income from delivery service rendered others, $25.40; P. Peterson, March bill, $2,500 less 2%; Uintah Copper Co., March bill, $1,755.85 less 3%; Al Morton, balance of March bill, $3,533.42 less 1%; J. J. Tommich, March bill, $3,979.98 less 2%; discounted note at 30 days **8%**, due May 26, for $10,000.

Cash Disbursements—Korn Products Co., April bill, $5,820.20 less 3% salesmen's salaries $5,000; salesmen's traveling expenses $4,720.80; advertising $5,000; shipping clerks, etc., $1,250.70; packing supplies $150.50; freight and drayage bills $1,206.17; Reid Murdock, April bill, $8,954 less 2%; Grand Grocery, March bill, $3,821.95 net; Washburn Crosby, balance of March bill, $6,972.80 net; rent for May $250; light and power $92.25; office salaries $750; office expense $8.50; office supplies $97.60; general expense $95.68; sales display room furniture $375; comptometer and filing cabinets for office $750; new horse $315; associated charities $20.10; cash was short $3.19; Ward drew $750; Gneisel $500; paid on April 24, Austin, Nichols Co. draft with adjustment of $350.

Instructions

Be careful to make proper entry of the equipment transferred from office to store; of the railroad refund; and the delivery service income. To book the $10,000 discounted note payable, in the cash book, show

the face of the note discounted in the General column; the discount in the Sales Discount column but mark a small "x" in front of it; and the net cash as usual. The Austin, Nichols draft transaction, with $350 adjustment, will have to be entered partly in the cash book and partly in the Journal, the Note Payable debit being posted in two parts. Be careful to get the debit and credit of the transaction. Give ample explanation in the Journal, covering also the cash portion. In the cash book simply refer to the Journal entry for explanation.

CHAPTER XXXIX

SALES

Importance of the Sales Department

According to a common classification of business activities, any business organization may be divided into four major departments: (1) Production or Buying, (2) Selling, (3) Financial Administration, and (4) Accounting. In point of relative importance, the selling department ranks first. Regardless of the efficiency secured in the other branches, regardless of the economy in buying and the excellence of administration, the life of the business largely depends upon the results obtained by the selling division.

Since the sales department plays such an important part in the development of the business, it is evident that all accounting and financial problems connected with sales should be given careful attention and should be handled by the most scientific and up-to-date methods.

As has been stated before, one of the most important principles of modern accounting is that the system by which the records are to be kept must be planned in advance. The modern accountant must first know what kind of information the record is desired to present, and he will then so classify the accounts that the desired information may be obtained from the ledger at any time, with the least possible additional effort.

Basis for Sales Classification

Applying this principle to sales it must be observed that the great majority of enterprises at the present time

deal in a number of commodities, the kind, quality, and grades of which are of such variety that careful classification is imperative. Formerly all goods were classed together under a single title "Merchandise," with the result that no detailed information concerning particular goods, qualities, and grades was available and the manager or proprietor was unable to study the movement of specific classes of commodities.

The basis for classification depends on the character of the business and the nature of the goods sold. Where the commodities dealt in are of such variety that it is impracticable to have a separate account for each kind, a more general grouping by classes may be had. Where the concern manufactures some of its commodities and buys the remainder in the open market, an analysis of sales on the basis of "own" product and "other" product may be wanted. Sales may also be classified on the basis of the sales contract, as cash, credit, instalment, sales to branches, consignment sales, approval sales, etc. Accounting problems in connection with these various types of classification will be treated in the present chapter.

The Sales Analysis in Books of Original Entry

When it is once decided what kind of classification is to be shown in the ledger, it is evident that the same kind of analysis must be used in the sales journal. The manner of analysis in books of original entry always depends upon the way in which the items are distributed over the pages, which may be either vertically or horizontally.

Principles Governing Booking the Analysis

In most forms or records, except in banking and allied institutions, it is generally accepted practice to reserve vertical distribution for showing chronological sequence,

while any other kind of classification is accomplished by horizontal distribution. The reason for this lies in the fact that the time basis requires practically unlimited space and this requirement can be met only by vertical distribution, because consecutive pages are here treated as the continuation of preceding pages. Horizontal distribution, on the other hand, is limited to the width of the page.

By reference to Chapter XXXV, "Handling the Cash," it will be noted that for the purpose of horizontal classification the sheet contains a number of money columns, each headed by an individual class title, and that each item is first entered in the general column and then extended to one of the subsidiary columns. Since the liability to error is comparatively great, it is of importance that the sheet should provide for an internal check. This is accomplished by entering *all* items in the general column and then extending each to one of the distributive columns. It is evident that the total of the general column must be equal to the sum of the totals of the other columns, thus furnishing a fair though not complete proof that the extensions were made correctly. All books, where analytical processes are involved, should provide some kind of internal check. The student should refer also to Chapters XIX and XX where a form of the analytic journal and explanation of it were given.

Use of the Sales Ticket in Analysis

Since the sales invoice or ticket is the basis for entry and analysis in the sales journal, it must give on its face the information necessary for making the analysis. In accordance with the basis of classification used, it should show the department number, the kind of goods sold, whether for cash or credit, etc. The use of invoices with printed department numbers and of different colors for cash,

charge, and C. O. D. sales, aid in making the record effective.

In a business of any size, the entry on the main sales journal only shows the total for the day's sales. The sales tickets lend themselves easily to grouping, and therefore a day's sales may be analyzed by sorting and grouping the sales tickets. Under any method of this sort, of course, each ticket must be used for the record of only one class of goods. Thus, the totals of each of these sorted groups may be entered in the sales journal at the end of the day.

Besides furnishing the totals for each group of sales, the individual tickets are used also for the purpose of posting the sales to the accounts of the particular customers.

After use in these various ways the tickets are filed away in binders for reference. In this way, the main books are freed of a mass of comparatively unimportant detail, and it may be said here that only in rare cases is it necessary to refer back to the original sales ticket for full particulars.

Analyzing Sales Returns

Attention should be called to the necessity of analyzing returned sales, allowances, and rebates on the same basis as sales. Provision should also be made for a separate returned goods journal, since the ordinary journal does not lend itself economically to an analyzed record of that kind.

Purchases and Returned Purchases

It has been pointed out that the basis of classification of sales in the ledger determines the analysis in the sales journal. The same basis of classification should also be

applied to purchases, returned purchases, and inventories, because only in this way is it possible to determine the profit from the different classes of merchandise.

Similarly, all inward costs such as duty, freight, insurance, handling, etc., which enter into the cost of goods sold must be analyzed on the same basis and each share must be applied to each particular group according to the analysis. Because of practical difficulties, however, this analysis usually is not made upon its first entry on the records, but a distribution on a more or less arbitrary basis is made at the close of the period. In a large concern where very detailed information as to results is desired, an analysis of many other expenses and costs applicable to each sales group is made. This, however, carries us into the field of cost accounting which is beyond the scope of the present discussion.

The Handling of Cash Sales

A simple method of booking cash sales, where no analysis of kind of commodity is desired, is by entry in a "Sales" column provided in the cash book. The column total would be posted to the credit of "Sales" in the ledger. Under this method, cash sales need not be entered in the sales journal. In previous chapters where the functions of the subsidiary journals were discussed, the practice of entering a cash sale in both cash book and sales journal was advised. This seems best in order that the summaries of each may show true totals for those groups of business activities. However, this principle is often departed from and the method just described for booking cash sales is followed. Where an analysis of the sales is desired, the practical difficulty of providing analysis columns in the cash book for the cash sales in addition to analysis columns in the sales journal for the sales on account, gives added weight to the principle stated.

Some managements desire that the cash sales be posted separately, i.e., in an account by themselves, thus requiring two accounts, the "Sales on Account" and the "Cash Sales," to show the total sales for the period. This is easily accomplished by the use in the sales journal of the "On Account" and "Cash" columns whose totals would furnish the amounts for posting to the two ledger accounts. Even were it desired to have two sales accounts, the cash and charge, for each department in a business operating a sales analysis feature, the necessary information could be secured by providing in the sales journal two columns, a cash and a charge, for each department and posting their totals to the two sales accounts carried for each.

A more complicated problem, however, arises when it is desired to keep an account to show the total cash sales of *all* departments and at the same time include these cash sales with the charge sales and show both in departmental sales accounts. The information can be placed on the ledger, but in such a way that it destroys the usual meaning of the Cash Sales account. It is accomplished by providing the sales journal with two total or general columns—in addition to the departmental columns—one for charge and one for cash sales, and by carrying a "Cash Sales" column in the cash book. The items in the Cash Sales column in the sales journal are distributed to the proper analytic columns for classification. At the end of the period the totals of these analytic columns (which include both cash and charge sales items) are posted to the credit of the proper departmental accounts in the ledger. The total of the Cash Sales column in the sales journal, however, is posted to the *debit* of Cash Sales in the ledger, which will be offset by a corresponding credit item from the Cash Sales column in the cash book. Ordinarily, these two totals would agree provided the books are completely posted.

Sales to Branches

Sales to branches are made on different bases in different concerns. Sometimes such sales are charged to the branch office at cost, sometimes at full selling price, and sometimes at a fictitious figure. The first method, whereby the goods are charged at cost, is theoretically the best, but is not always desirable because head offices frequently prefer to keep their branches ignorant as to cost prices.

For this reason such sales are frequently charged to the branch office at regular selling price. By this method, however, the books of the head office show these goods as if they were actually sold, while in reality they are merely transferred to a branch office. Consequently, the books show a profit which is not yet earned. In order to correct this, it is necessary at the end of the period to make an adjustment entry covering all goods still in the possession of the branch office unsold at that time.

By billing the goods at a fictitious figure the branch is also kept in ignorance as to real profits but proper adjustment should be made at the close of the period for the same reason as explained in the preceding paragraph.

Whichever method is followed, sales to branches should always be kept separate from the regular sales accounts. Where the sending of goods to branches is frequent and in regular order, a branch shipments journal similar to the sales journal should be provided. Otherwise a special column in the sales journal might suffice. The total of such sales should be credited to a Branch Shipments, Branch Consignments, or similar account so as not to confuse these transactions with regular sales.

Consignment Sales

It may be remarked here that consignment sales also should be recorded separately from regular sales. This is

so because the title to goods out on consignment is still vested with the consignor and no element of profit appears in the transaction until actual sale is made. However, in the case of an *occasional* consignee as distinguished from a factor who deals regularly in consigned goods, it has usually been held that the title has passed to the consignee so far as the consignee's dealings with all except the consignor are concerned. Only in this way can the interests of innocent third parties be adequately protected.

The accounting for consignments is treated in Chapter L.

Instalment Sales

The instalment sale should be treated in a different manner from regular sales because of certain special features connected with it. The chief characteristic of the instalment sale is the probability of the goods' coming back into the seller's possession through forfeiture by non-payment of instalments, and the profit on the transaction of course being affected thereby. The problem is simply stated here, its handling being deferred to Chapter LIII.

Sales for Future Delivery

From a legal point of view, the receipt of a purchase order gives rise to certain rights and obligations enforceable at law between buyer and seller. While the seller might not be able to enforce specific performance of the contract, yet he would be entitled to the damage incurred through non-performance. Every merchant knows, however, that the cost of securing the remedy is usually higher than the resulting gain and, furthermore, an action against the customer frequently causes the loss of his trade.

Sales for future delivery do not always materialize, since either the buyer or the seller may wish to cancel the

contract. A conservative policy therefore demands that the sale be not booked until delivery is made. The order, however, may be received in one fiscal period and the sale be credited to the period in which the goods are delivered, while the major part of the expenses in connection with the sale was probably incurred during the period in which the order was received. The current period then is charged with the expenses but does not receive the credit to which it seems entitled. Therefore, the portion of the selling expense incurred during the period in which the order was secured should be deferred to the period which receives the credit for the sale.

This policy should be followed even when the goods covered by the future sale are set aside specifically for future delivery and the sale should not be booked until delivery is made. At inventory time such goods should be included at cost, with the deferred expense charge as above. Occasionally, an unscrupulous merchant in need of cash will bill such goods and discount the invoice; but for the reason given above such goods should not be charged to the customer until delivery is made.

Department Store Sales

As indicated above, in a department store it is usually required to classify sales by departments. The two classes of sales tickets, cash and credit, are sorted by departments and the totals are entered either in the sales journal or on the loose sales sheets which will make up the journal. This is the entry for the day. At the end of the month the journal is posted to the various department sales accounts. Each day the entries on the sales journal are checked against the cashier's record of cash received from sales and the bookkeeper's record of charges posted to customers.

C. O. D. Sales

For this class, the credit is booked in the usual way and the debit made to a C. O. D. account. The packages are charged by the shipping department to the various delivery men and they are credited with the collections turned in by them. Any balance in the C. O. D. account shows the amount of the undelivered goods still on hand in the shipping department.

The Bill and Charge System

By this name is known the method of writing up the customer's bill and using it as the basis for the charge to his account. It is operated somewhat as follows: A duplicate of each sales ticket goes to the auditing department. There they are first sorted by departments to secure the departmental analysis of the sales, and then resorted according to customers. Thus, if a customer has made purchases in more than one department, the tickets covering all his purchases are brought together. Each customer's monthly bill or statement of account is started at the beginning of the month on a folded billhead perforated at the fold, the duplicate or under portion usually being somewhat wider, with loose-leaf binder punchings. On these bill and duplicate blanks the charges for the day are entered from the sorted sales tickets. This work is usually done on a billing machine with carbon roll or with carbon paper insertion.

At the end of the day the total amount of the charges entered on all monthly statements is either found by means of an adding machine or is indicated by the "tally strip" of the billing machine. This total must, of course, be equal to the aggregate amount of all sales tickets for that day, thereby proving the work of the billing clerks.

Customers' bills after entry each day may either be

passed on to the bookkeepers who charge each customer's account with the day's total purchases as shown by the bill, or the bills are returned to the file till used again for subsequent purchases. In such case the bookkeepers use these bills only once a month to enter the total monthly charge to the customer's account.

Returned goods and allowances are also entered on these customers' bills, but in a separate column.

The total charges entered on these statements must check against the total credit sales for the month, thus proving the additions of the bills.

At the end of the month the bill is torn from its duplicate and is passed to the bookkeepers. They enter the previous month's balance, if any, and the current payments on account and extend the amount now due. These bills or statements are then mailed to the customers. The duplicate bills are filed away, being virtually the detail of the ledger account, for use in case of dispute.

This method of handling credit sales provides a ready means of getting the bills out on time, of assuring agreement between the ledger accounts and the bills, of freeing the ledger accounts of unnecessary detail, and of checking the total billings against the total sales tickets.

Salesmen's Commissions and Efficiency Records

Salesmen are often paid a commission in addition to salaries. Where the commission is based on the amount of sales, the sales ticket again becomes the source of information. At the end of the day, or at any other time, these tickets are re-sorted according to salesmen and a record sheet, either separate or as an adjunct to the sales journal sheets, is filled in with each salesman's total for the day. These totals should prove against the salesman's record in the back of his book of sales tickets. At the

end of the month, each salesman's total sales is shown by his record sheet and his commission is determined therefrom. Of course, the total for all salesmen as shown by these sheets must equal the total sales for the period.

If the commission, often known as "spifs" or "P. M.'s," is allowed only on certain classes of sales in order to encourage the movement of old stock, each sales ticket should indicate the amount of premium or commission due, so that house record can be made without the necessity of depending on the individual salesmen's records.

Salesmen's records besides being used for the particular purpose of computing commission or bonuses due them, serve a wider object in that they contain fairly complete and reliable data in regard to the value and efficiency of individual salesmen. For this reason such records should be kept at all times, no matter whether a commission or bonus system is operated or not. Whenever an increase in a salesman's salary is considered or when the sales force is to be decreased in number, these efficiency records furnish a valuable basis for making the right decision.

PRACTICE DATA*

(*Assignment for Chapter XXXIX*)

Post completely and take a trial balance as of April 30. In summarizing the debit side of the cash book previous to posting, remember that included in the Sales Discount column is an item of bank discount on the firm's $10,000 note, which must be shown separately and charged to Interest Cost. Be sure you show this in the summary entries, in addition to the Sales Discount summary.

To accomplish this the total of the Sales Discount column is best shown in two portions, the Sales Discount total on the one line, and the Interest Cost item on the next line.

*See Practice Data for Chapter XXXVIII.

CHAPTER XL

CAPITALIZATION OF THE PARTNERSHIP

The Real Capital

From an accounting viewpoint, the real capital of any business enterprise is the excess of its assets over its liabilities. Usually, the main fund of capital is secured by original contribution. In a partnership, each of the partners makes some investment which provides the common partnership fund. Thereafter, additions to the capital may be secured in several ways:

1. Profits may be left in the business instead of being withdrawn.
2. Specific contributions may be made by the partners, which are either to be considered as additions to their capital investment, or are to be treated as more or less temporary loans to the business.
3. Outside capital may be borrowed.
4. A new partner may be taken in, his contribution producing an increase in the partnership capital.

The present chapter deals with original investments and with the first three types of additional capital mentioned above, while the next chapter discusses the admission of new members and the consolidation of partnerships.

Original Contributions

It sometimes happens that the partnership agreement does not state specifically how much each partner shall invest in the business. For example, the agreement may say

that partner A is to contribute certain properties, i.e., place of business and equipment; that B shall contribute a stock of goods, and that the investment of the remaining partners shall consist of cash, the exact amount of which is not stated but depends upon the valuation placed upon the property and merchandise invested by A and B.

After valuations are placed upon these properties, and the amounts of the cash contributions thus made definite, it may be found that the total investment thus obtained is more than the business requires. Or, it may happen that some of the partners do not have sufficient funds available to pay their shares, while others may be able to contribute more than their respective shares. It thus happens that the partnership agreement is not always rigidly enforced, some partners contributing more, and others less, than the agreed amounts. This is at the time looked upon as a temporary arrangement, but often results in a permanent condition. The partnership agreement should contain provision for such a contingency. If not, a later agreement should be made whereby the relations between the partners are regulated.

Adjustment of Capital Contributions

Whenever a partner contributes more than his agreed share, it is customary to allow him interest on the excess amount, and other partners whose investment may be less than agreed are usually charged with interest. This is obviously an equitable method of meeting the situation.

As a rule, these interest adjustments are handled through the Profit and Loss account, i.e., the partners who invest less than the agreed share are considered to owe interest to the partnership as such, and those who invest more have an interest claim against the business and not against the other partners individually. The debit or credit balance in

the Profit and Loss account resulting from these adjustments is in turn distributed among all partners in profit or loss sharing ratios. It should be clearly understood, however, that although these adjustments are made through the Profit and Loss account, yet there is no element of business profit or expense involved. For this reason, these interest entries should be made direct in the appropriation section of the Profit and Loss, and should never be booked in the regular Interest accounts.

The following illustrations will bring out the different methods of adjustment:

A, B, and C are equal partners under an agreement to contribute each $15,000. Provision is made that excess contributions are to be credited with interest at 6% and that deficits are to be charged at the same rate. The records show that actual contributions were: A, $18,000; B, $13,000; and C, $11,000. The problem is how to adjust the partners' accounts in accordance with the agreement. Three methods of adjustment will be shown.

First Method

A's excess is $3,000, interest on which is $180.
B's deficiency is $2,000, interest on which is $120.
C's deficiency is $4,000, interest on which is $240.

These interests are brought on the books by the following journal entries:

Profit and Loss	$180.00	
A		$180.00
B	120.00	
C	240.00	
Profit and Loss		360.00

The Profit and Loss account then shows a credit balance of $180, which is distributed as follows:

Profit and Loss	$180.00	
A		$60.00
B		60.00
C		60.00

The net effect of these adjustments is a credit to A of $240, with debits to B and C of $60 and $180 respectively.

Note that A is credited with $180 for his excess of $3,000, and Profit and Loss is debited with the same amount, because it is the business that owes this interest to partner A. If this Profit and Loss debit were distributed separately, A's share in it would be $60, so that his real credit on his $3,000 excess is not $180 but $120. On the other hand, the combined debits to B and C result in a credit to Profit and Loss of $360, and, if this item were distributed as such, A's share would be $120, thus making his total credit on the complete adjustment $240. A similar explanation would apply to the adjustments for B and C.

Second Method

The first method was based on a consideration of the respective excesses or deficits on capital investments, but the same result may be obtained by comparing all contributions with the amount of the smallest investment, viz., $11,000 by C. This would show A's excess over C as $7,000, and B's excess over C as $2,000, and these two amounts may be treated in the nature of loans to the business. The result is that A is credited with 6% on $7,000, and B with 6% on $2,000, as follows:

Profit and Loss	$540.00	
A		$420.00
B		120.00

The debit to Profit and Loss is charged in equal shares to the three partners as follows:

A	$180.00	
B	180.00	
C	180.00	
Profit and Loss		$540.00

and the final result shows a net credit to A of $240, a net debit of $60 to B, and a net debit of $180 to C, the same as by the first method.

Third Method

The total capital contributed is $42,000. To be equal partners under the agreement, each should have contributed one-third of the common fund, or $14,000. Actually, A's investment is $4,000 in excess of this, while B's deficit is $1,000 and C's deficit $3,000. The excess contribution of A, $4,000, may be looked upon as in the nature of loans to B and C as individuals, to bring their shares up to the $14,000; viz., $1,000 to B and $3,000 to C. Instead of making the adjustment through the Profit and Loss account as in the first two methods, the interest is now adjusted between the three partners as private persons, the entries affecting only the partners' personal accounts. This would result in a credit to A and a debit to B for $60, A having loaned B $1,000; and a credit to A and a debit to C for $180, for the loan of $3,000 to C. A's total credit would again be $240, and B's and C's debits respectively $60 and $180, the same as by the other two methods.

Thus it is seen that any of the three methods employed leads to the same results. It will be observed, however, that in the example given the contemplated investments were to be equal amounts for the three partners ($15,000), and the profit and loss was to be shared on the same basis. The three different methods of adjusting interest lead to the same results only when the profit-sharing ratio is identical with the ratio between the contemplated investments.

Averaging Investments

In the case of partnerships of a temporary nature, organized for carrying out a particular undertaking, very often the amount of capital needed is not known and may vary at different stages of the undertaking. Here, the partners usually contribute as need arises, and withdraw when funds not needed in the business become free. As stated in Chapter XXXIV, such additional contributions are frequently made without regard to any specified ratios, but whenever additional money is needed it is furnished by those partners who have available funds at that time. Under such conditions, the partnership agreement should always provide the manner in which the partners' interests are to be adjusted. A common method of adjustment as explained and illustrated in Chapter XXXIV is to compute the average investment of each partner and to use these amounts as the basis for profit-sharing. In this way the problem of interest adjustment as such is completely eliminated.

Accretions of Capital Through Profits

At the close of the fiscal period, when results are summarized, the net profits are transferred to the partners' accounts. The amount of profit left in the business usually is different for different partners. It is evident, therefore, that the partners' capital accounts at the end of the period usually show a different ratio from that existing at the beginning. Assume that a given partnership consists of two members, one investing $2,000 and the other $1,000, and that profits are to be shared in the same ratio as these original investments, i.e., 2:1; assume further that at the end of a number of years the capital ratios have completely changed, the present capitals being, say, $8,000 and $24,000 respectively. Obviously, under such circumstances it would not be just for the first partner still to receive twice

as much profit as the second partner, because the *original* investment ratio was 2:1. Similar conditions frequently occur. One instance is known of a partnership of two men, one of whom at the start furnished the entire capital of a few thousand dollars. The other, by leaving his profits in the business in much larger measure than the first, soon overtook him and finally when the business had grown to a half-million dollar concern he had a larger interest in it than the partner who had furnished the entire original capital.

Whenever it is intended that profits are to be shared on the basis of investments, the profit-sharing ratio should be changed from time to time in order to correspond with actual investments and this should be plainly stated in the partnership agreement.

Another way in which justice may be done to the partner whose investment increases more rapidly than that of the others, is by allowing him interest on his excess investment, as has been explained. It should be the policy of the firm to offer some such incentive to the members to have them leave their surplus profits in the business and so prevent the need of borrowing from the outside.

Finally, it may be said that in the event of dissolution, accretions through profits constitute claims against the firm ranking before the partners' capitals. Virtually, they partake of the nature of loans and for this reason they are sometimes carried in *partners' loan accounts* in order to keep them separate from the original capital investments, or are left in the "Personal" accounts which are not then closed into the "Capital" accounts.

Additional Contributions and Loans

When contributions are made by partners there should be a specific understanding as to whether these funds are

to be considered as additional capital or as loans to the partnership. In the first case the items should be shown in the capital accounts of the partners, thus equitably requiring a change in the profit-sharing ratio—although a change is not always made; and in the second case they are entered in the partners' loan accounts with corresponding interest adjustments as has been explained.

Loans by the partners may be evidenced by firm notes signed by all partners and given to those making the loan. However, these notes should not be carried in the regular Notes Payable account because that account represents the firm's liability to outsiders, which must ordinarily be met promptly according to the terms of the instrument. At common law, a partner may not bring suit against the firm of which he is a member; hence, there is an essential difference between these two kinds of notes. For this reason, a new account is opened entitled Partners' Notes Payable which is credited whenever the firm issues a promissory note to any of its members. Where the loan is not evidenced by a formal note, record should be in the partner's loan account. As has been stated, any loans made by partners to the business rank before regular capital claims, and this priority is not changed when such loans are evidenced by promissory notes.

Borrowed Capital

It may happen that a firm is obliged to borrow funds from outside in order to increase its working capital. For instance, the partners may have no available private funds for further investment and yet may not desire to admit new capital on a profit and loss sharing basis. Such loans usually are on a long-time basis, and should not be included in the Notes Payable account. A special account should be opened, e.g., Notes Payable Special, Mortgage, or other title plainly

indicating the nature of the loan. Sharp distinction should be made between funds borrowed for the purpose of increasing the permanent capital, and money borrowed for current needs. The need for additional current funds usually results from a slow collection of customers' accounts or slow movement of stock, while the need for increased capital is caused by the fact that the original capital investment is insufficient to meet present conditions.

PRACTICE DATA*

(Assignment for Chapter XL)

Summarized transactions for May were:

Purchases—Washburn Crosby Co., n/10, $10,149.60; Federal Macaroni Co. 2/20, n/30, $5,219.80; United Supply Co., 3/5, 2/20, n/30, $8,620.95; Delico Food Products Co., 5/5, n/30, $5,419.40; Van Dusen Co., 8/5, 5/10, 2/30, n/90, $7,684.25; Kataguri Bros., 3/10, n/60, $6,714.80; cash purchases $537.92.

Sales—Las Vegas Cattle Co., 3/5, n/20, $1,200; U. B. Zipkin, 1/5, n/60, $4,760.40; J. Henry Witt, 2/10, n/30, $5,120.60; J. J. Tommich, 2/5, n/20, $2,130.65; Al Morton, 1/10, n/30, $1,825.75; J. R. Rice, 3/5, n/60, $3,250.75; Circle Bar Ranch, 3/5, n/20, $1,314.55; Uintah Copper Co., 3/10, n/30, $1,192.20; P. Peterson, 2/5, n/60, $4,376.80; J. Perlman, 1/5, n/30, $3,895.35; Progressive Stores Co., 3/5, n/20, $5,940.65; Russo Bros., 2/10, n/30, $1,937.50; Wm. Crick, 1/10, n/30, $2,562.45; Gristede Bros., 1/10, n/30, $10,842.25; M. J. Downing, 2/10, n/30, $3,947.75; Casazza & Sons, 1/5, n/30, $2,100; Capella Bros., 2/5, n/60, $2,875.42; S. Brown, 3/10, n/30, $1,987.60; Black Hills Mining Co., 1/10, n/30, $987.15; J. Johnson, 1/5, n/60, $1,236.40; Ward drew groceries $100; cash sales $6,725.43.

Journal—received goods returned by J. Henry Witt of his April purchase as unsatisfactory, $1,320.70; out-freight for April was $125.90; received goods returned by Progressive Stores Co., error in filling order, $1,560.90; cash over for this month was accounted for by failure to record kindling sales, $30.25; received spoiled goods from Gristede Bros., $2,150; received from M. J. Downing, I. B. Perkins' 6% 60-day note due July 15, $2,000, to apply on account; returned to United Sup-

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

ply Co. goods, on account of error in filling our April order, $1,580.20; gave Van Dusen Co. our note dated May 8 at 60-day, non-interest bearing, but with 60 days' interest, $50, included in the face, for their bill of April $9,825.35 less 5% discount and cash payment of $4,334.08 for balance.

Cash Receipts—Quinn Bros., April bill $3,975.20 net; Stewart & Son, balance of April bill, $2,755.35 net; S. Koenig, April bill, $2,875.45 net; M. E. Dietrich, April bill, $4,150.60 less 2%; Jas. Butler, Inc., balance April bill, net $3,572.55; C. A. Gerken, April bill, $2,875.60 less 3%; John Johnson, April bill, $3,105.20 less 1%; Jacob Green, April bill, $2,900 less 3%; Gristede Bros., $4,500 on account; cash was over $30.25; C. N. W. Ry. settled our claim of $325 for Gerken by paying $250; sold packing supplies, $15.75; Casazza & Sons, May bill, $2,100 less 1%; Black Hills Mining Co., April bill, $2,160.50 net; Evans Sons, April bill, $2,760.46 less 2%; Andrew Davey, April bill $3,840.90 less 3%; J. Henry Witt, May bill, $5,120.60 less 2%; U. B. Zipkin, $5,000 on account; Las Vegas Cattle Co., $2,500 on account; Dodts' Grocery note $1,517.18 came due May 20 and was paid with interest; Lewiston School Bonds' interest for the half-year was received May 24.

Cash Disbursements—Salesmen's salaries $6,250; salesmen's traveling expense $6,100.50; advertising $5,280.17; shipping expense $1,392.20; shipping supplies $120; in-freight and cartage, $1,319.18; rent for June, $250; insurance policy for 1 year, May 1, 1917, to May 1, 1918, $240; light and power $140.69; office salaries $980; Armour Packing Co., April bill, $6,256.55 less 2%; Holland Gelatine Works, April bill, $7,778.90 less 2%; Van Dusen Co., $4,334.08 on account as above; United Supply Co., balance of April bill, $7,122.95 less 2%; office expense $19.15; office supplies $175.20; general expense $138.20; furniture for store $625; cash was short $27.80; donations to charity $18.75; paid our note at the bank $10,000; Ward drew $350; Gneisel $500.

Instructions

Transfer the large credit of $30.25 in Cash Short and Over to Miscellaneous Sales. The receipt of $250 from the railroad in settlement of our claim against them might be set up as a credit to Freight Claims Income were it desirable to have the information as to income from that source. It is perhaps best handled as a credit to Sales Returns and Allowances to offset the charge here made at the time of the customer's complaint about lost goods; it will be so treated here.

The effect of adding interest to the face of a non-interest bearing note is to secure a compounding of the interest if the note is not paid at maturity, as the note will bear legal rate of interest after maturity. Be careful to get the debit and credit of this transaction with Van Dusen Co., both in cash book and in Journal.

CHAPTER XLI

OTHER PARTNERSHIP PROBLEMS

Admission of a New Partner

In Chapter XXXIV a distinction was made between buying out an interest in a business and making an investment in a business. In the former case no new capital is acquired, while in the latter the capital of the firm is increased by the amount of the new partner's contribution.

When a new partner is admitted he usually acquires not merely the right to share in the profits but he also obtains a share in the net worth (often called ***net assets***) of the enterprise. For this reason it is necessary that all the partners, including the new member, are agreed as to the value of the net assets, and in this connection any of the following possibilities may arise:

1. Upon admission of the new partner the book accounts may be considered to represent the true status of the business. A balance sheet is drawn up and the new partner is admitted on the basis of the net worth shown thereby.

2. It may be considered that the assets are not worth the amount at which they have been carried on the books and a new valuation is placed upon them.

3. Or there may be reasons why the business is considered to be worth more than the amount shown by the balance sheet.

First Case

In the first case little difficulty is met in making the entry for admitting the new partner. For instance, if the

balance sheet shows a net worth of $30,000, and the new partner wishes to make an investment in order to secure a one-fourth interest in the firm, the amount to be contributed is evidently $10,000. Assuming that he makes a cash investment of $10,000, the following entry would meet all accounting requirements:

Cash	$10,000.00	
A, Capital		$10,000.00

As a result of this cash investment of $10,000 the net worth of the new firm now amounts to $40,000 and the one-fourth interest belonging to A is evidenced by his capital account at $10,000. The new firm may now continue the old records and no further adjustments will have to be made.

Second Case

In the second case it is necessary to place a new valuation upon the assets of the old firm and the accounts of the old partners must be adjusted accordingly. For instance, suppose A and B are equal partners and the financial status of the firm is shown by the following balance sheet:

BALANCE SHEET OF A & B

Cash	$1,000.00	Notes Payable	$3,000.00
Accounts Receivable	10,000.00	Accounts Payable	5,000.00
Merchandise	6,000.00	Mortgage on Bldg	4,000.00
Building and Equipment	16,000.00	A, Capital	10,500.00
		B, Capital	10,500.00
	$33,000.00		$33,000.00

More capital is needed and C is invited to make an investment. Upon investigation he finds there are in-

cluded under Accounts Receivable many old items of which it is estimated $1,000 will be uncollectible; the merchandise is overvalued to the amount of $500, and the building and equipment are worth $1,500 less than is shown on the books. He offers to make an investment to secure a one-fourth interest and his offer is accepted.

As a result of the new valuations placed upon the assets, the net worth of the firm now is $18,000, against the old showing of $21,000. Consequently, the capital accounts of A and B are reduced from $10,500 to $9,000 each. The new partner is to invest a certain sum sufficient to acquire a one-fourth interest in the new business. Hence the combined capital of A and B, $18,000, will represent three-fourths of the new capital and consequently the amount to be invested by C equals $6,000. Thus the new capital of the firm will amount to $24,000, one-fourth of which, or $6,000, is credited C's capital account.

The balance sheet of the new firm will show:

BALANCE SHEET OF A, B & C

Cash		$7,000.00	Notes Payable	$3,000.00
Accounts Rec.	$10,000		Accounts Payable	5,000.00
Less, Reserve	1,000	9,000.00	Mortgage on Bldg.	4,000.00
			A, Capital	9,000.00
Merchandise		5,500.00	B, Capital	9,000.00
Building and Equipment		14,500.00	C, Capital	6,000.00
		$36,000.00		$36,000.00

The firm has thus secured $6,000 additional capital, on a basis somewhat unfavorable for the present, but, inasmuch as the books now show conservative values, no ultimate injustice is done any of the partners.

Third Case

The third case shows the firm in a position to demand something more than book values as the basis for admission of the new partner. It presumes that the old firm is favorably known, has an established trade and patronage built by fair dealing and judicious advertising, by favorable location, and the numerous other ways in which a substantial business may be developed. Its standing in the community is a factor of real value to the firm because it brings trade to their doors. Other conditions being equal, a firm which enjoys a good reputation is worth more than a new venture. All of the factors bringing about such condition are usually classified as good-will. The essence of good-will is the ability to produce above-normal profits, i.e., profits above the average in that line. Consequently, whenever the members of a firm consider the admission of a new partner, i.e., when they intend to sell a part of their interest in the business to an outsider, good-will is regarded as one of the *assets* of the existing enterprise, thereby increasing its net worth.

The valuation of good-will, however, is a difficult matter and it is a well-established principle that good accounting will not allow the asset good-will to be set up on the books of a concern unless it has come into possession of it either by purchase or when a part of its own good-will is sold to a new partner. In this case the price received for the portion sold becomes the basis for valuing the whole of it.

The following case will serve to illustrate the foregoing discussion:

Suppose that X has a one-half interest in a firm, and Y and Z a one-fourth interest each. The balance sheet of this partnership is shown in the following summarized form:

BALANCE SHEET OF X, Y & Z

Cash	$2,000.00	Liabilities	$10,000.00
Other Assets	48,000.00	X, Capital	20,000.00
		Y, Capital	10,000.00
		Z, Capital	10,000.00
	$50,000.00		$50,000.00

An outsider, R, is now to be admitted as a one-fifth interest partner by investing $12,500, while the relative shares of the others are to remain as before. Hence, after R's admission X will have two-fifths, and Y, Z, and R one-fifth interest each. It is further assumed that no revaluation of the assets is necessary.

The net worth of the old firm is seen to be $40,000. If book values were taken as the basis for admitting R, an investment of $10,000 would be sufficient to acquire a one-fifth interest in the new firm. However, it is considered that the business is worth $10,000 more than the $40,000 shown in the balance sheet, and for this reason, instead of paying $10,000, R is required to invest $12,500. The excess of $2,500 is paid by R as an offset to the shares of the others in the good-will of the firm. There are three ways of treating this good-will element, viz.:

First Method. Debit the Good-Will account for the amount actually paid for it by R, viz., $2,500, and credit the capital accounts of the old partners in proportion to their shares in the profits:

Good-Will	$2,500.00	
X, Capital		$1,250.00
Y, Capital		625.00
Z, Capital		625.00

As a result of this entry, the capital account of X would be $21,250, and those of Y and Z $10,625 each. The capital account of R, however, would show a credit

of $12,500. In other words, R's interest in the net assets—although not in the profits—of the business as shown by his account would be *larger* than that of Y and Z, while as a matter of fact he was to have an equal share. For this reason, this method of treating good-will is not satisfactory.

Second Method. According to this method the matter is looked upon from a different standpoint. Taking book values as a basis, the share bought by R is worth only $10,000. However, on account of good-will, the real value of this share is considered to be higher and R is required to pay $12,500 for it. Hence, in order that the books may show actual values, this good-will item must be added to the assets of the old firm, at the same time increasing the capital accounts of X, Y, and Z in proportion to their shares in the profits. The entry would be:

Good-Will	$10,000.00	
X, Capital		$5,000.00
Y, Capital		2,500.00
Z, Capital		2,500.00

As a result of this adjustment the capital of the old firm is shown as $50,000. R now invests $12,500; the capital is thereby increased to $62,500. The capital accounts of the four partners now show $25,000, or two-fifths, for X, and $12,500, or one-fifth, each for Y, Z, and R.

Third Method. Under this method of handling good-will, the extra $2,500 invested by R is treated as a bonus for distribution among the members of the old firm outside the business, their capital interests in the new firm showing the same as in the old and R's appearing at $10,000. There is no objection to this method if R is satisfied.

Of the three methods, the second usually proves the most satisfactory.

Another, though a similar problem, involving the handling of good-will is encountered when a member of an ex-

isting firm sells out his interest, including a share of the good-will, to another who takes his place in the firm. Here the transaction may be looked upon as a private deal between buyer and seller, in which case the buyer merely succeeds to the seller's interest in the firm, his capital appearing the same as the seller's former capital interest even though he paid more for it; or the good-will may be brought onto the books and the capitals of all the partners be shown at increased figures just as under the second method above.

Consolidation of Partnerships

There are various reasons why the consolidation of partnerships may be of mutual advantage to the individual firms concerned. For instance, when two or more firms consolidate, the competition which formerly existed between them is eliminated and co-operation takes its place. By uniting their businesses, many of the operations which were formerly performed by each are now co-ordinated with resulting savings of every kind. Many other advantages may result from consolidation of individual firms.

However, looked upon from the standpoint of the accountant, the consolidation of partnerships is essentially of the same nature as the admission of new partners, the same principles applying to both.

Before actual consolidation takes place, it is necessary for each of the partnerships to place a new valuation upon its assets and that the new figures be agreed upon by all concerned. In almost all cases good-will enters in as an important factor. Aside from the booking of good-will, the accounting problem involved has to do mainly with the work of the auditor when investigating conditions as to profits and profit-earning capacity in order to have a correct basis for estimating the good-will of the member firms. Conditions affecting profits in the various firms must be

equalized as nearly as possible so that the earning capacity of the firms can be compared on an equitable basis. Such questions as the way in which salaries to the partners, interest on capitals, withdrawals, and loans have been handled in the various firms, the relation of outside-the-business profits to the profit-showing of any of the member firms, and whether the consolidation contemplates taking over this source of profits—these and similar questions must be considered and treated equitably for all concerned.

The following illustration is given in order to assist the student in solving problems incident to consolidations.

A and B, equal partners in an established business, consolidate with C and D, equal owners of an allied business. A and B are each to have a one-third, and C and D each a one-sixth interest in the new firm. The following balance sheets show their financial positions:

BALANCE SHEET OF A & B

Cash	$2,500.00	Notes Payable	$5,000.00
Notes Receivable	1,000.00	Accounts Payable	8,000.00
Accounts Receivable	22,000.00	Mortgage on Real Estate	4,000.00
Merchandise	10,000.00	A, Capital	16,000.00
Furniture and Fixtures	2,500.00	B, Capital	16,000.00
Delivery Equipment	1,500.00		
Real Estate	9,500.00		
	$49,000.00		$49,000.00

BALANCE SHEET OF C & D

Cash	$5,000.00	Notes Payable	$5,000.00
Accounts Receivable	15,000.00	Accounts Payable	7,750.00
Merchandise	8,000.00	C, Capital	9,000.00
Furniture & Fixtures	2,000.00	D, Capital	9,000.00
Horse & Wagon	750.00		
	$30,750.00		$30,750.00

A careful valuation of the various properties shows that the balance sheet of C & D represents conservative values. In regard to A & B's figures, however, it was decided to allow $2,000 for possible bad debts, and to value their merchandise at $9,000, delivery equipment at $1,000, and real estate at $9,000. Furthermore, it is agreed that C & D's good-will shall be valued at $5,000, and A & B's at $10,000.

After making the required adjustment entries the new balance sheets will show as follows:

BALANCE SHEET OF A & B

Cash		$2,500.00	Notes Payable	$5,000.00
Notes Receivable		1,000.00	Accounts Payable	8,000.00
Accounts "	$22,000		Mortgage on Real Estate	4,000.00
Less, Reserve	2,000	20,000.00		
Merchandise		9,000.00	A, Capital	19,000.00
Furniture and Fixtures		2,500.00	B, Capital	19,000.00
Delivery Equipment		1,000.00		
Real Estate		9,000.00		
Good-Will		10,000.00		
		$55,000.00		$55,000.00

BALANCE SHEET OF C & D

Cash	$5,000.00	Notes Payable	$5,000.00
Accounts Receivable	15,000.00	Accounts Payable	7,750.00
Merchandise	8,000.00	C, Capital	11,500.00
Furniture and Fixtures	2,000.00	D, Capital	11,500.00
Horse and Wagon	750.00		
Good-Will	5,000.00		
	$35,750.00		$35,750.00

It is agreed that C and D's capitals are to be taken as the one-sixth basis for capitalization of the new firm, and A and B will each contribute $4,000 in cash to bring their

capitals up to the required amounts. The opening balance sheet of the consolidated firm will then read as follows:

BALANCE SHEET OF A, B, C & D

Cash		$15,500.00	Notes Payable	$10,000.00
Notes Receivable		1,000.00	Accounts Payable	15,750.00
Accounts Receivable	$37,000		Mortgage on Real Estate	4,000.00
Less Reserve	2,000	35,000.00	A, Capital	23,000.00
Merchandise		17,000.00	B, Capital	23,000.00
Furniture and Fixtures		4,500.00	C, Capital	11,500.00
Delivery Equipment		1,750.00	D, Capital	11,500.00
Real Estate		9,000.00		
Good-Will		15,000.00		
		$98,750.00		$98,750.00

Partners' Loans in Relation to Firm Credit

So far as the credit of a firm is concerned, loans made by partners to the firm may be viewed in two very different ways. If there is no suspicion as to the standing and financial condition of the firm, the fact that the partners themselves, who know the real condition better than any outsider, are willing to put additional capital into the firm, is the best evidence that the firm is prospering. Consequently, loans made by partners under such conditions help to increase the firm's credit.

On the other hand, if the integrity of the members of the firm is questioned, even then the loan made by a partner would make a better showing than a loan from an outsider since in case of insolvency and dissolution the partner's loan ranks *after* the claims of outside creditors. However, if a partner has invested large sums of money either as additional capital or as a loan, in case of financial trouble he may attempt secretly to withdraw part of the assets from the business and to conceal the true condition

of affairs from the creditors. Being on the inside he is in a position to do this before outsiders could even scent trouble.

It sometimes happens that a firm allows one or more of its members to loan the firm comparatively large amounts of money and gives them demand notes as evidence of such loans. If the partner holding such a note is of an unscrupulous character, he may present it for payment at maturity and, if the firm is unable to pay, may demand an "accounting." He may even go further and cause the dissolution of the firm and thereupon repurchase the interests of the other partners at much less than their true value. This is one scheme by which dishonest men have sometimes succeeded in "freezing out" their partners in business. These and similar matters belong rather to the field of fraudulent finance, but are mentioned here because the accountant is sometimes called upon to deal with financial problems of this kind.

Practice Data*

(Assignment for Chapter XLI)

Post completely and take a trial balance as of May 31.

*See Practice Data for Chapter XL.

CHAPTER XLII

PARTNERSHIP PROFITS

Ambiguity of Definition of Profits

The term "profits" as applied to business is perhaps used with as little uniformity as any term met with. When a concern speaks of its profits it is difficult to know exactly what is indicated thereby, because the meaning of the term depends very largely on the point of view of that particular concern. The reported profits of different firms are not a true basis for judging the relative worths of these concerns, unless it is known exactly how certain items, about which practice varies, have been handled in the particular cases. The net profits of a single proprietorship or of a partnership are usually derived in the same manner, although even here there is variation in the treatment of some items such as salaries, drawings, interest on capital invested, etc. The partnership form, like the single proprietorship, contemplates an investment on the part of the owners not only of capital but also of time and effort. This is one of the differences as to working organization between these forms and the corporation. Investment in the corporation is of capital only. If services are employed by the corporation, they are paid for and charged as services, salaries, etc.

Compensation for Time and Services

The partnership form presumes active and direct management of the business on the part of the owners. Where this is not the situation, as is sometimes the case in a limited partnership, or whenever one or more of the partners is not active, that partner is usually penalized in his share of

the profits by the allowance of salaries to the managing partners before any distribution of profits in the agreed ratio to all the partners. Thus, in partnership profits is included the element of salaries, not only salaries as such but, in general, a recompense for the time and contributed ability of the proprietors. The man who makes an investment in a partnership does so usually because he desires to invest his time as well as his capital. He expects, therefore, to receive not only a fair rate of interest on his money but also pay for his services with the firm.

Interest on Investment

In the chapter on interest, the rate paid for the use of money was seen to be dependent both on the money market and on the element of risk involved in the particular investment. In mining ventures where frequently the certainty of return of the principal is small, the interest rate is sufficiently high to offset, during the life of the loan, the loss of the principal at the end. So an investor in a partnership, because of the element of risk in comparison with that of so-called absolutely safe investments, requires a higher rate of return under the title, interest, than he would in an ordinary investment in good securities.

Partnership Profits Defined

Partnership profits, therefore, contain these two elements—interest and recompense for services. If profits are extraordinary, above normal, such excess may be and usually is the measure of the more-than-average ability of the partners, or it may result from local conditions, partaking of the nature of monopoly profits.

It is the purpose of this chapter to lay down a correct definition of profits and to show the method of their disposition and to discuss related problems.

Partnership profits or the net profits of a partnership are easier of definition by a statement of what should not be considered in their determination, than by attempting to give an itemized list of the income and expense items entering therein. In speaking of profits in this way, the term is used in a technical accounting sense and has reference to the manner of their showing in the Profit and Loss account and its content. That account or statement usually develops a so-called net profit which is distributed to the partners.

We may say, therefore, that the net profit of the business is the profit determined *before* interest on owners' capital investments and the recompense to the partners on account of time and services are taken into account. In the ordinary partnership, all such items as interest on capital investments, salaries to partners, etc., are not to be considered as expense items to be deducted from profits *before* the net earnings are determined, but these items themselves constitute a part of the distribution of the net profits to the several owners of the business. They are employed simply for the purpose of distributing net profits according to certain methods agreed upon by the members of the firm.

Profit and Loss for Comparative Purposes

In order that the Profit and Loss account may serve as a basis for periodic comparisons, it should have a fairly uniform content from year to year. It should develop what may be called a net operating profit, in the calculation of which, account should be taken of all ordinary income and expenses incurred in the operation of the business. This will provide the basis for comparisons, between periods, of the ordinary normal activities of the business.

In the "Other Income" section all outside-the-business income and expense should be considered, such as income

from investments outside the business and expenses in connection therewith. Items of extraordinary income and expense, however, usually are taken directly into the partners' accounts, i.e., are not cleared through the Profit and Loss and so do not destroy the value of the results shown by that account from year to year. Instances of such extraordinary items are profits arising through the sale of good-will, profits realized on the sale of real estate, extraordinary losses from fire, etc.

In this way, while the purpose of the Profit and Loss is to summarize all of the temporary proprietorship accounts, yet for the sake of making that summary of greater value to the proprietors, some proprietorship items may be omitted. Such a method of handling is not in conflict with principles previously laid down, but rests upon the general principle that accounting methods and forms are not hard and set but must conform in particular cases to the requirements met with; they must be flexible to local conditions else they fail in their full purpose and efficiency.

Allowance of Salaries

The allowance of salaries to partners is not so much for the purpose of measuring the excess of the profits of the partnership over what the individual owners might have earned by working for others, as it is for the purpose of equalizing or adjusting their interests on an equitable basis. When, on the one hand, men invest their abilities and services in addition to their capitals, and on the other hand, the profit and loss sharing ratio is determined on the basis of the capitals invested, some adjustment must be made in order that the greater ability of a given partner may be recognized and compensated by a salary. Thus a partner of exceptional ability secures a larger share in the profits by receiving a fixed amount under the head of salary, the remaining part

of the net profits being divided among all partners in the profit and loss sharing ratio.

Allowance of Interest

It sometimes happens that still another basis of profit-sharing is introduced in the partnership agreement. This is the device of an interest allowance to the partners for contributing in excess of the agreed amount and an interest charge on partners' deficiencies of capital.

This method of equalizing unequal investments is set out in detail in Chapter XL. It is a fair arrangement to all concerned. The effect of such a provision is to secure a distribution of profits on a dual basis, viz., a part of the profits as interest on the capitals in the capital ratio and the remainder of profits in the profit and loss ratio. Thus, two partners A and B whose capitals are $10,000 and $15,000 respectively, with a 6% interest allowance on capital and a subsequent half and half distribution of profits, have in effect a profit-sharing on two different bases. Suppose the profits are $6,000. The interest requirement will give A $600 and B $900, after which $4,500 will be divided equally. Interest on partners' capitals is thus in no sense an operating expense and should be handled always in the appropriation section of the Profit and Loss.

If the partnership agreement makes specific provision (but not otherwise), interest may be charged on partners' drawings. This is merely an additional device for adjusting the partners' interests, and causes a slight difference in the net shares of profits to each. Where interest is allowed on capitals and also charged on drawings, the partners' accounts Personal and Capital combined in one, are virtually accounts current, and the interest computations may be made as explained in Chapter LII in connection with accounts current.

Interest on Partners' Loans

Careful differentiation must be made between interest on partners' capitals and partners' loans. Had the loan been made by outside parties its interest cost would have been treated as a business expense to be taken account of before the determination of net profits. The fact of its being a loan from a partner does not in the least change the manner of showing the cost of it. Interest on partners' loans is not therefore to be handled in the appropriation section of the Profit and Loss but should be charged to the regular Interest—or Interest and Discount—account and cleared through the Profit and Loss. The credit is usually to the partners' personal account, or to cash if actually paid.

Closing Profits to Partners' Accounts

The disposition of profits under a partnership does not differ materially from that under the single proprietorship form. When the net profits are determined, they belong to the proprietors and are usually transferred to their accounts. The method of the transfer may be either by way of the partners' personal accounts or direct to the capital accounts. The principle involved in either treatment was discussed at the time of closing the books for the single proprietorship and will not be repeated here. Where the partners do not desire to have any change shown in their original capital accounts, the profits may be transferred to loan accounts for each of the partners or they may stand as open balances in their personal accounts.

Reserved Profits

In rare cases, before the determination of the partners' shares in the net profits, some portion of the profits is reserved for some specific purpose. The profits so reserved are transferred from Profit and Loss to a named

reserve account to indicate their retention in the business. If these items were transferred to the partners' accounts, they would be subject to withdrawal from the business. Even when they are shown in the reserve account, however, they belong to the proprietors and are just as much a part of the net worth of the business as if shown in the proprietors' accounts. Such reservation of profits may be for the purpose of providing for the replacement of some fixed asset when it wears out, as building, machinery, etc., for the meeting of a liability when it comes due, or other similar purposes. This, however, is very seldom done in partnernership accounting and a complete treatment of the problem is reserved for the work of the second year in connection with corporation accounting.

It should be noted that reserves of this kind must not be confused with valuation accounts like reserves for depreciation and bad debts. These are in no sense a reservation of net profits but merely adjustment entries whose contra debits to depreciation or bad debts are expenses to the business and have been taken into account before the amount of net profits is determined.

Distributing a Deficit

The appropriation section of the Profit and Loss thus usually shows only the distribution of net profits to the partners' accounts. A thorough understanding of the partnership agreement is necessary before the proper distribution can be made. If the agreement provides for salaries and interest on capitals and drawings, these must first be considered even though there are not enough net profits to satisfy these requirements. Their purpose, as explained above, is to equalize conditions and interests among the partners preliminary to their sharing in the profit and loss ratio. If this equalization results in a deficit, a deficiency

of profits, that deficiency will then be distributed in the agreed ratio and to that extent nullify some portion of the profits distributed as salaries and interest. If specific provision in the articles of copartnership requires a different handling of the salaries and interest items, that provision, of course, governs. Otherwise these items should be treated as above.

If any of the partners leave profits in the business, it usually results in a changing ratio of the capital account balances. Where the distribution of profits is based upon the original contributions, it is advisable to transfer the profits left in the business to separate loan accounts for the partners. The partners' capital accounts then always show their original contributions.

Partners' Withdrawals

Partners' withdrawals and salaries are usually handled in a very unsystematic way. The amount of the drawings allowed each partner during a given period should be definitely determined by agreement, and regular checks should be issued for the amounts drawn. The payment of partners' personal bills and the handling of any other personal items should never take place on the firm's books, as all personal bills should be paid out of personal funds. It also frequently happens that salaries, when allowed, are not drawn regularly. The best method of handling this is by crediting the partners' personal accounts with the salaries due them and by charging these accounts with all actual drawings whether those drawings are for salary or otherwise.

Profits Determination Upon Admitting a New Partner

In connection with the determination of profits, particular care should be taken to get as nearly as possible a correct net profit at the time of any change in the partners' relations.

Upon the admission of a new partner, failure to make entry in the old partners' accounts of any profit rightfully belonging to them would mean a sharing of it with the new partner and consequently a loss to the old partners.

In like manner the deferring of an expense charge, rightfully belonging to the period before the admission of the new partner, to the period after the admission, results in a wrongful burden on the new partner.

Similarly, when a partner is admitted on a changing profit ratio basis (as when he is admitted to a one-fourth share for three years, at the end of which time he is to have a one-third share), an incorrect determination of profits may mean a loss either to him or to the old partners. So long as the same partners continue, no inequity results through failure to include some such items in their proper periods, as they are cumulative and will be taken effect of in later periods. However, this is no excuse for a slip-shod, inaccurate determination of profits at any time.

PRACTICE DATA*

(Assignment for Chapter XLII)

Summarized transactions for June were:

Purchases—Grand Grocery, n/10, $7,978.45; Armour Packing Co., 2/20, n/30, $9,768.30; Reid Murdock Co., 3/5, 2/20, n/30, $12,567.90 Austin, Nichols & Co., 5/5, n/30, $8,675.20; F. Mezzadri, 8/5, 5/10, 2/30, n/90, $1,793.35; Korn Products Co., 3/10, n/60, $5,787.85; Swift & Co., 2/5, n/30, $9,652.40; cash purchases were $786.45.

Sales—R. B. Kennan, 2/10, n/30, $3,967.20; Blue Front Grocery, 2/5, n/20, $1,282.95; Four Corners General Store, 3/5, n/60, $1,875.60; Dodts' Grocery Store, 3/5, n/20, $2,500.55; Andrew Davey, 3/5, n/30, $3,125.60; H. A. Krebs, 1/30, n/60, $3,527.80; M. Heitzman, 3/10, n/30, $3,768.95; Fein Bros., n/5, $4,280.20; Fred Henry, 2/5, n/60, $5,192.67;

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

Evans Sons, 2/10, n/30, $1,875.20; Dewey Brown, n/5, $1,225.80; Badgley & Stewart, 1/5, n/30, $1,937.60; Bulls Eye Mining Co., n/10, $875.20; Quinn Bros., n/10, $3,120.67; Stewart & Son, 1/5, n/30, $3,940.55; S. Koenig, 2/10, n/30, $4,120.65; M. E. Dietrich, 2/5, n/60, $2,900; Jas. Butler, Inc., n/5, $10,100.55; C. A. Gerken, 3/10, n/30, $1,762.40; John Johnson, 1/30, n/60, $789.63; Jacob Green, 3/5, n/30, $1,250; Casazza & Sons, 1/5, n/30, $1,320.25; Progressive Stores Co., 3/5, n/20, $575.80; Gristede Bros., 1/10, n/30, $3,140.20; J. Henry Witt, 2/10, n/30, $2,769.75; Ward drew groceries $35; Gneisel drew groceries $65; cash sales were $7,267.40.

Journal—Out-Freight for May was $150.50; received goods returned as unsatisfactory from Andrew Davey, $525, from Fred Henry, $1,540.10, from S. Koenig, $1,750.90; received from Capella Bros., A. M. Tuttle's 90-day 6% note, for $2,500, dated May 24, with 24 days' interest accrued to date, which we allow them, in payment of their May bill $2,875.42 less 2% and cash payment of $307.91 to balance; returned inferior goods to Reid Murdock Co. $2,180.20 and to Swift & Co. $1,650.80; cash shortage of May was partially accounted for by failure to book purchase of shipping supplies, $20.25.

Cash Receipts—Jacob Green, June bill, $1,250 less 3%; M. J. Downing $1,000 on account; Capella Bros. $307.91, balance as above; J. Johnson, $1,000 on account; Bulls Eye Mining Co., April bill, $3,219.65 net; M. Heitzman, June bill, $3,768.95 less 3%; Wm. Crick, $2,000 on account; Russo Bros., $1,500 on account; Progressive Stores Co., balance May bill, $4,379.75 less 3%; J. R. Rice, $3,000 on account; Al. Morton, $1,500 on account; J. J. Tommich, May bill, $2,130.65 less 2%; M. J. Downing's note for $1,680.40 came due June 10 and was paid with interest; cash was over $2.50; sold horse costing $225 for $175; sold 3 Lewiston School Bonds at par and 30 days' accrued interest; Ward made a loan to the business at 6%, dated June 15, of $5,000; sold kindling, etc., $51.25.

Cash Disbursements—salesmen's salaries $6,000; salesmen's traveling expense $6,396.90; advertising $4,498.80; shipping expense $1,180.35; shipping supplies $225.40; freight and drayage $1,310.75; rent for July $250; office salaries $960; office expense $9.75; office supplies $189.15; general expense $91.75; cash was short $2.25; gifts to charity $15.90; Ward drew $150; Gneisel $125; Kataguri Bros., $4,000 on account; Van Dusen Co., May bill, $7,684.25 less 5%; Delico Food Products Co., $3,000 on account; Federal Macaroni Co., $5,000 on account; Washburn Crosby, $3,000 on account; new delivery equipment $750.

Instructions

Make a careful analysis of the Tuttle note transaction before at-

tempting the formal entry of it. Give full explanation in the Journal, including explanation of the cash portion. In the cash book, the only explanation needed is a cross-reference to the Journal, such as "See J——." For the delivery horse transaction, clear H. W. & H. account of the horse sold, at cost price, by debiting Cash and Depreciation and crediting H. W. & H. with the full amount. Record the sale of the Lewiston Bonds as a credit to the Bonds account which will require adjusting at closing time to show the loss on the transaction. Credit Ward's loan, to his "Loan" account.

CHAPTER XLIII

PROBLEMS AND METHODS CONNECTED WITH SUMMARIZING THE PERIOD'S RESULTS

Introductory

The method of adjusting and closing partnership books is on the whole identical with the method previously discussed in connection with the sole proprietorship. One exception is that the distribution of profits involves certain problems not met with in the one-man enterprise, but these problems were amply discussed in the preceding chapter. The student should refer to this Chapter XLII for the content of the appropriation section of the Profit and Loss account as handled for a partnership. It is the purpose here to review briefly the entire field of adjustment and closing from the partnership point of view, and to explain more fully certain special points which received only partial attention in the chapters on sole proprietorship.

Adjustments

As stated in Chapter XXIX, the books of account usually do not reflect the true condition as to all items recorded. At the end of a fiscal period, however, it is desired to know the exact status as to assets, liabilities, and net worth; also the correct amount of income and expense for the period must be determined.

Hence, before the ledger can be used to furnish this information, the accounts must be so adjusted as to represent actual conditions as of the closing date of the period.

The main points concerning which the books fail to reflect true condition are: the amount of goods on hand at

the close of the period; depreciation of various assets; the amount of expected losses from uncollectible accounts and notes receivable; expense items which were charged during the current period, but apply in part to later periods, i.e., deferred expenses; expenses for services used during the current period but not yet entered as charges, i.e., accrued expenses; income items received and credited during this period, but applying in part to services to be rendered by the business in a later period, i.e., deferred income; income earned during the current period, but not yet entered on the books, i.e., accrued income.

Problems Connected with the Merchandise Inventory

The most important of these problems is the adjustment necessary on account of the merchandise on hand at the end of the period. In this connection certain problems of a special character are usually met with and will be discussed here.

Goods in Transit

It may happen that certain goods have been ordered during the period, and that the invoice has been received but that the goods themselves are still in transit. The question whether or not such goods shall be included in the inventory may be viewed from different angles, as follows:

1. If the goods have been paid for in advance, they were undoubtedly entered on the books as a charge to Purchases. If this is the case, the goods in transit must, of course, be included in the inventory the same as if they were actually received.

2. If the goods are still in transit, but have not been paid for, it is customary not to charge them to Purchases until they arrive. If not charged to Purchases, they must not be included in the inventory. However, theoretically

this method is incorrect. The fact that the goods were ordered and are now in transit makes the business liable for the purchase price, and the goods, although not actually received, in reality form a part of the assets of the purchases. It is true that until the goods are received, inspected, and accepted, the purchaser has the privilege of refusing them if they are not as ordered, but this privilege is exercised only in exceptional cases. Generally speaking, therefore, it is better to consider such goods as a completed purchase, include them in the inventory and credit the vendor for the amount of his invoice.

Goods Received but Not Yet Booked

In the case of goods which have actually been received but for some reason or other have not been entered on the books, complete record should be made and the goods must, of course, be included in the inventory. In concerns where a separate shipping and receiving department is maintained, it may happen that goods are received by this department but are not immediately transferred to stock or storage. At the end of the period it is important to see that all such goods are properly recorded as purchased and are included in the inventory.

Goods In or Out on Consignment

Still another problem in connection with the inventory has to do with consigned goods. If at the close of the period certain goods are held for sale which do not belong to the business but were consigned to it for sale on account of the owner, they must not be included in the inventory. Sometimes such goods are taken into stock and mingled with those belonging to the firm, and, if this is done, it is very important that these goods should be so marked as easily to distinguish them from the regular stock.

Similarly, if goods were sent out on consignment to another market, they still belong to the business and must not be overlooked at inventory time. If the proper record were made at the time the goods were shipped, as will be explained in Chapter L, the memorandum accounts on the ledger would call attention to them. In some concerns all such goods are entered as sales at the time of shipment. In such cases it may happen that at the end of the period part of these consigned goods are still in the hands of agents unsold. These goods should be deducted from the sales for the period and included in the inventory at full cost.

Goods for Future Delivery

Goods sold for future delivery are best handled at inventory time in the manner suggested in Chapter XXXIX, even if they are set aside ready for delivery.

Goods Ready for Current Delivery

Finally, goods sold for current shipment but delayed in delivery on account of congestion in the service or other causes are best treated as sales and excluded from the inventory.

Methods of Recording Deferred Expenses

It will be remembered that deferred expense items are items which are charged in a given period but in reality apply to a succeeding period. One method of adjustment was discussed in a previous chapter and consisted in crediting the current expense account with the amount not chargeable to it and entering this same amount on the debit side of the new account. The balance of the old account then constitutes the expense applicable to the current period and is closed out to Profit and Loss. This method may be called the expense method because it treats the account from an expense point of view.

Sometimes another method is adopted which may be called the asset method. This method handles the portion chargeable to this period's Profit and Loss in pretty much the same way as depreciation on any asset, except that the amount of the used or consumed portion is not set up in a separate valuation account. In other words, the adjustment of the account is made by means of the closing entry instead of through an adjusting entry. Under the expense method, the account is adjusted first to show its true expense element chargeable to the current period, and then this element is transferred to Profit and Loss. Under the asset method, the portion chargeable to the current period's expense is transferred to Profit and Loss and the account balance thus shows the "asset" portion still on hand. An illustration will bring out the differences. Suppose the insurance charged has been \$500 and \$125 is unused at the close of the period. Under the expense method the entries are:

Insurance (Deferred)	\$125.00	
Insurance		\$125.00
To adjust.		
Profit and Loss	375.00	
Insurance		375.00
To close.		

The ledger account would show as follows:

INSURANCE

	\$500.00	Inventory	\$125.00
		Profit and Loss	375.00
	\$500.00		\$500.00
Inventory	\$125.00		

Journal entry and ledger account under the asset method:

Profit and Loss	$375.00	
Insurance		$375.00
To transfer.		

INSURANCE

	$500.00	Profit and Loss	$375.00

Preference is given to the expense method because it makes formal entry on the journal of the amounts of all such items and so draws attention to them, and, further, brings the ledger to a correct showing before closing. The chief advantage of the asset method is its saving in time in making the entry.

The asset method is applicable also to the other expense and income adjustments.

The Summary Accounts

In Chapter XXX, where the method of closing the books of a single proprietor was discussed, it was seen that all expense and income accounts are closed into a single clearing account, i.e., Profit and Loss. Even there it was shown that certain accounts, i.e., Purchases and Sales, are sometimes used as subsidiary clearing accounts, and that all items entering into the cost of goods sold are transferred to the Purchases account instead of directly to Profit and Loss. Similarly, the accounts used in the determination of net sales were transferred to the Sales account.

The Trading or Selling Account

In a trading business an additional clearing account called Trading or Selling is sometimes used. Its purpose and content are indicated by its title. It is used to clear all accounts connected directly with selling the product and

summarizing the results up to that point. It would, therefore, handle net sales, cost of sales, salesmen's salaries, sales commissions, advertising, delivery expense, etc.; and its balance, showing a so-called net trading profit, is transferred to Profit and Loss and becomes the first entry therein. Here the rest of the clearing and summary work is done and the net profit disposed of just as formerly. The only advantages of the use of the Trading account are said to be that this account draws attention by its name to the summary of that class of activities of the business and that it relieves the Profit and Loss of some items where the number of the closing accounts to be summarized is large.

It should be said that some authorities use the Trading account for a summarization of the items entering into cost of goods sold and net sales; this work has here been handled in the Purchases and Sales accounts respectively. When so used, the balance of the Trading account is the gross profit on sales which is transferred to the Profit and Loss account. Inquiry and observation of methods in actual use lead the author to believe that the Trading account as such is largely an academic tool, a teaching device, and is seldom met in practice.

Posting the Closing Entries

Where the number of temporary proprietorship accounts to be summarized is small, there is an advantage in showing them in detail as explained in Chapter XXX. However, in a business of any magnitude usually only the totals of the profit and loss items as shown by the compound journal entries are set up in the Profit and Loss account. A good method to follow in making up the journal entries is to classify the closing items to accord with the main sections of the statement of profit and loss. In this way the posting to the Profit and Loss account will show the total figures for Net

Sales, Cost of Goods Sold, Selling Expenses, General Administrative Expenses, etc.—figures which give a good bird's-eye view of the period's activities.

The Balance Sheet

The partnership balance sheet does not present any problems which have not yet been discussed and the student is referred to Chapter XXX where ample treatment of the subject is given.

The Working Sheet

Some accounting instruction makes use of a so-called six-column statement for a condensed summarization of the period's results, using two columns for the trial balance, two for the profit and loss items, and two for the balance sheet. This, at the best, is a lame instrument for its intended use. However, with the incorporation of two more columns between the trial balance and the balance sheet columns, indicating the adjustments required before the books can be closed, the form becomes a very valuable aid in the work of summarization. Such a statement is termed a working sheet, and its use in connection with the trial balance is explained by the illustration on pages 388 and 389.

It will be seen that the first two columns of the working sheet are an exact copy of the trial balance. The trial balance should be arranged in classified form before being entered on the working sheet, as this aids greatly in drawing up the statements.

TRIAL BALANCE, DECEMBER 31, 1916

Cash	$1,500.00	
Notes Receivable	2,000.00	
Accounts Receivable	12,500.00	
Reserve for Doubtful Accounts		$200.00
Merchandise Inventory	15,000.00	

TRIAL BALANCE—*Continued*

Delivery Equipment	1,250.00	
Depreciation Reserve for Delivery Equipment		250.00
Plant and Equipment	7,500.00	
Depreciation Reserve for Plant and Equipment		1,250.00
Land	10,000.00	
Accounts Payable		7,500.00
Mortgage Payable		5,000.00
J. W. Davis, Capital		18,000.00
J. W. Davis, Personal	2,000.00	
W. F. Bingham, Capital		12,000.00
W. F. Bingham, Personal	1,500.00	
Sales		30,500.00
Cash Sales		14,200.00
Sales Returns and Allowances	2,150.00	
Purchases	25,500.00	
In-Freight	1,000.00	
Sales Salaries	3,600.00	
Advertising	750.00	
Insurance	500.00	
Trade Expense	1,000.00	
Office Salaries	900.00	
Office Expense	150.00	
Building Repairs	50.00	
Interest and Discount	200.00	
Sales Discount	750.00	
Purchase Discount		900.00
	$89,800.00	$89,800.00

ADJUSTMENTS

Inventory of Merchandise	$16,490.00	(a)
Advertising Materials on Hand	125.00	(b)
Sales Salaries Accrued	200.00	(c)
Office " "	60.00	(d)
Interest on Mortgage	150.00	(e)
" " Notes Receivable	50.00	(f)
Insurance Unexpired	200.00	(g)
Create the following reserves:		
Doubtful Accounts, 3% of the outstanding accounts receivable		(h)
Depreciation Delivery Equipment, 20%		(i)
Depreciation Plant and Equipment, 5%		(j)

WORKING

	Trial Balance December 31, 1916	
Cash	$1,500	......
Notes Receivable	2,000	......
Accounts Receivable	12,500	......
Reserve for Doubtful Accounts	......	$200
Merchandise Inventory	15,000	......
Delivery Equipment	1,250	......
Depreciation Reserve for Delivery Equipment	......	250
Plant and Equipment	7,500	......
Depreciation Reserve for Plant and Equipment	......	1,250
Land	10,000	......
Accounts Payable	......	7,500
Mortgage Payable	......	5,000
J. W. Davis, Capital	......	18,000
J. W. Davis, Personal	2,000	......
W. F. Bingham, Capital	......	12,000
W. F. Bingham, Personal	1,500	......
Sales	......	30,500
Cash Sales	......	14,200
Sales Returns and Allowances	2,150	......
Purchases	25,500	......
In-Freight	1,000	......
Sales Salaries	3,600	......
Advertising	750	......
Insurance	500	......
Trade Expense	1,000	......
Office Salaries	900	......
Office Expense	150	......
Building Repairs	50	......
Interest and Discount	200	......
Sales Discount	750	......
Purchase Discount	......	900
Bad Debts	......	......
Depreciation	......	......
Net Profit	......	......
	$89,800	$89,800

SHEET

Adjustments		Balance Sheet		Profit and Loss	
......	......	$1,500	......	......	......
......	......	2,000	......	......	......
......	......	12,500	......	......	......
......	h $375	......	$575		
a $16,490 (B)	a 16,490	16,490	......	$15,000	$16,490
......	......	1,250	......	......	......
......	i 250	......	500	......	......
......	......	7,500	......	......	......
......	j 375	......	1,625	......	......
......	......	10,000	......	......	......
......	......	......	7,500	......	......
......	......	......	5,000	......	......
......	......	......	18,000	......	......
......	......	2,000	......	......	....
......	......	......	12,000	......	......
......	......	1,500	......	......	......
......	......	......	......	......	30,500
......	......	......	......	......	14,200
......	......	......	......	2,150	......
......	......	......	......	25,500	......
......	......	......	......	1,000	......
c 200	c 200 (B)	......	200	3,800	......
b 125 (B)	b 125	125	......	625	......
g 200 (B)	g 200	200	......	300	......
......	......	......	......	1,000	......
d 60	d 60 (B)	......	60	960	......
......	......	......	......	150	......
......	......	......	......	50	......
e 150 f 50 (B)	e 150 (B) f 50	 50	150	300	......
......	......	......	......	750	......
......	......	......	......	......	900
h 375	......	......	......	375	......
i 250 j 375	......	......	......	625	......
				$52,585	$62,090
......	......	......	k 9,505	k 9,505	......
$18,275	$18,275	$55,115	$55,115	$62,090	$62,090

In the adjustments columns are entered both the debit and the credit of all adjusting items, not in exact accordance with their debit and credit when making the formal entry on the journal, but rather according to the use made of the particular items in drawing up the periodic statements. The purpose of the columns is not to adjust and close the books in a complete and formal manner, but rather to gather all of the adjusting data so that a correct separation of the balance sheet and profit and loss items can be made for use in the formal entries and statements. Thus, instead of showing the final inventory of merchandise as a debit to Merchandise Inventory and a credit to Purchases, both the debit and credit are entered in Merchandise Inventory, the debit or asset element being followed with a capital "(B)" to indicate its final distribution to the balance sheet columns. The initial inventory, shown in the trial balance column, and the credit entry of the final inventory in the adjustments column, are distributed, without combining, into the profit and loss columns. This method makes the profit and loss columns show the actual figures needed for use in the statements, whereas a combined or net figure would require tracing back to get the necessary data.

The other entries in the adjustments columns may be explained in a like manner. In all cases the "(B)" following an item is for the purpose of indicating its distribution into the balance sheet columns, whereas its contra debit or credit, as the case may be, is combined with the corresponding figure in the trial balance columns before distribution.

After all adjustments are made and their place of final distribution indicated, a complete distribution of all items in the trial balance and adjustments columns is made either to the balance sheet or the profit and loss columns. The difference between the profit and loss columns will thus show the net profit or loss for the period and is the item

needed to balance the balance sheet, thus proving the work.

The difference between the profit and loss columns is $9,505, this constituting the net profit for the period. By adding the item to the credit balance sheet column, the balance sheet columns should, of course, show equal totals. On the books and in the formal statements this net profit must be shown distributed to the partners in agreed ratios, and may be so shown on the working sheet, though this manner of handling there is a little awkward.

As stated before, the working sheet is used for the purpose of a quick summarization of the results for the period in a single statement. It serves also as the basis for closing the books and drawing up the formal statements. It provides a convenient method of working from the trial balance and of incorporating in it the necessary adjustments. The use of the working sheet is, of course, not limited to partnership transactions, but it is employed in other types of business organization as well.

PRACTICE DATA*

(Assignment for Chapter XLIII)

Post completely and take a trial balance as of June 30.

*See Practice Data for Chapter XLII.

CHAPTER XLIV

PARTNERSHIP DISSOLUTION

Temporary Nature of Partnership

Because of the essential character of a partnership, its duration is necessarily limited. It must look forward to the time when its business will have to be wound up for one reason or another. The chief causes leading to a dissolution will be briefly reviewed.

Causes of Dissolution

1. The Withdrawal of Any Partner. Under ordinary circumstances a partner cannot be held to a specific performance of his contract. If a partner becomes dissatisfied, suspicious, or desires for other reasons to withdraw from his contract before its expiration, he has that power. It cannot be looked upon as a right but only as a power to be exercised under unusual circumstances. If his withdrawal before the agreement terminates results in damage to his copartners, they have a lawful claim against him for the amount of the damage. Under extraordinary conditions, specific performance of the contract might be decreed, i.e., the partner would not be allowed to withdraw.

Withdrawal does not relieve a partner from liability for debts incurred while he was a member of the firm. These creditors, if not paid by the firm, may hold the withdrawing partner. To be relieved from liability arising *after* his withdrawal, personal notice of withdrawal must be given to all the firms with which the partnership has been dealing. A published notice is considered sufficient notice to parties not dealing with the firm until after withdrawal.

2. Sale of a Partner's Interest or Admission of a New Partner. When a partner, with the consent of his copartners, sells his interest in the firm to another, or when a new member is admitted to the partnership, in the eye of the law, the old partnership has ceased to exist and a new one has taken its place.

3. Limitations in the Partnership Agreement. The agreement may specify the period for which the partnership is to exist. If a special partnership, the object to be accomplished may be stated and the firm is automatically dissolved as soon as the object is accomplished.

4. Mutual Consent of the Partners. Whether or not the partnership period is limited by the agreement, the partners may at any time rescind their contract by mutual consent.

5. Misconduct, Insanity, Death, Assignment, or Bankruptcy of a Partner. Any of these works a dissolution. By misconduct may be understood a member's failure to pay the agreed contribution of capital, failure to perform his duties, his acting in bad faith towards his copartners, etc.

6. Illegal Object. A partnership entered into for the pursuit of an object which later becomes illegal is automatically dissolved.

7. War between Nations Represented by the Partners. This dissolves the partnership, though such dissolution may be more in the nature of a suspension, inasmuch as the relation may be resumed upon cessation of hostilities.

8. Bankruptcy of the Firm. This results in the firm's assets' being sold to satisfy the claims of its creditors and the firm as such ceases to exist.

9. Sale or Transfer. A firm may sell out to another firm or change its form of organization to that of a corporation. The old firm, therefore, no longer exists.

Problems Incident to Dissolution

It is purposed to consider some of the problems involved in winding up the affairs of a partnership. From the schedule of causes given above it will be seen that a firm may be either solvent or insolvent at dissolution. The three statements sometimes set up in the case of insolvency—the Statement of Affairs, the Deficiency Account, and the Realization and Liquidation Statement—will not be explained here but the results obtained by them will be taken into account. These statements are seldom, if ever, met in practice, and are not standardized either as to form or content. Treatment of them is deferred till the work of the second year.

Partnership Provisions Covering Liquidation

Because of the certainty of final dissolution, it is not unusual for the partnership agreement to make definite regulations concerning the method of liquidation. The appointment of one of the members as liquidating partner, the manner of distributing the proceeds from liquidation, whether by instalments or otherwise, the manner of paying the liquidator for his services—all these may be provided for.

Where dissolution is forced by the death of one of the partners, to determine that partner's interest it would be necessary to take inventory and make appraisal of all the firm's assets. This may cause considerable inconvenience to the business, and, to avoid this, provision is sometimes made that the remaining partners shall continue the business and purchase the interest of the deceased partner. His share in the profits for the current period up to the date of his death may be determined not by taking inventory at that time, but by continuing the business till the end of the regular fiscal period and prorating the year's profit over the period in which the deceased had an interest. In this way.

while the partnership is automatically dissolved, a new one is immediately created and there is no need of liquidation. In a case like this, a basis is usually decided upon for the calculation of the firm's good-will so that the estate of the deceased partner shares in it, also. Usually interest is allowed the estate of the deceased partner from the date of his death until the settlement of his share.

Partners' Rights and Procedure During Liquidation

However, in many instances dissolution is accompanied by liquidation. All of the partners have equal rights to share in the work of liquidation. Since the work usually does not require the time of all the partners, a customary procedure is to appoint one member—or an outsider—as the liquidator. The fact of the dissolution is published in the leading newspapers, and the name of the liquidator is given in the notice. If liquidation is necessary because of the death of a partner, great responsibility rests upon the liquidator. He must act in the greatest good faith and endeavor to realize the best price possible for the assets of the firm in the interest of the deceased partner's estate. A similar responsibility rests upon him when liquidation is carried on in the interest of absent members.

The expenses and losses incident to liquidation must be borne by all in profit and loss ratio. The liquidator may be paid either by means of a commission on the sums realized or by a salary. If the liquidator is a partner, settlement may take place privately between the partners but a better method is to charge his commission or salary to the firm's liquidation expenses.

Liquidation may proceed by sale of the assets in regular order and may even permit the purchase of additional goods where necessary. This may be done in order to fulfil existing contracts or to complete partly manufactured goods,

or where stock on hand can be disposed of to better advantage by the addition of side lines or specialties.

Distribution of Proceeds

Upon the realization of the assets, application of the proceeds must be made in the following order: First, the claims of all outside creditors must be met in full or by compromise where not fully recognized. Second, the claims of the partners on account of loans or advances made to the firm must be satisfied. Third, the partners share in the remainder, by first taking out their respective capital contributions and then, if there is a balance, by sharing it in their profit and loss ratios. If, however, there be a loss this must be shared in the profit and loss sharing ratio before withdrawal of any capital contributions. The remainder, if any, is then divided among the partners in the ratio of their capitals as diminished by the loss. Whether the net assets are either more or less than the total amount of the capitals, the difference is shared in profit and loss ratio, and what then remains is shared in capital ratios.

Instead of a complete liquidation of the firm's assets, by mutual consent, certain of the assets may be taken over by each partner at agreed values and applied towards the satisfaction of his capital and loan interests. Such use of assets is spoken of as a *conversion* to that particular purpose. It must be distinctly understood that this is not a right which any partner can demand, but only a privilege granted by mutual agreement. Any partner can demand that all the assets be sold and that the proceeds be applied in satisfaction of all interests concerned.

Sharing Losses

In the case of insolvency, the partners are compelled to share the losses in profit and loss ratios, not in capital

ratios, and these losses are chargeable against their capital accounts. If the capital account of any of the partners is not large enough to satisfy his share in the losses, a deficit in that partner's interest results, represented by the debit balance in his capital account. This shows the amount which he must contribute to the firm in order that all claims may be satisfied. The rule that profits and losses in liquidation cannot be shared in the same ratios as capitals, is responsible for the fact that upon dissolution one or more partners may have to make additional contributions, while others are not obliged to do so. This duty of contribution is inherent in the partnership relation and can be enforced by the co-partners.

A few illustrations will set forth the main problems in connection with the liquidation of partners' capitals:

1. **Sharing Losses Equally**

BALANCE SHEET OF A, B & C

Cash	$10,000.00	Liabilities	$10,000.00
Other Assets	60,000.00	A, Capital	15,000.00
		B, Capital	20,000.00
		C, Capital	25,000.00
	$70,000.00		$70,000.00

A, B, and C share profits and losses equally.

Dissolution becomes necessary and in the course of liquidation the expenses and losses incurred amount to $15,000. The above balance sheet shows, in summary form, the condition of the firm previous to liquidation, and also indicates the shares of the partners in the net assets as on that date, i.e., the partners share in the net assets in the ratio 15:20:25 or 3:4:5. The net loss of $15,000 is now divided equally among the partners, after which the capitals will amount to,

A $10,000, B $15,000, and C $20,000. The result is that the capital ratio has changed from 3:4:5 to 10:15:20, or 2:3:4, and the net assets of $45,000 are to be shared in this new ratio.

2. Capital Deficit

BALANCE SHEET OF JONES & SMITH

Cash	$10,000.00	Jones, Capital	$20,000.00
Losses in Liquidation	15,000.00	Smith, Capital	5,000.00
	$25,000.00		$25,000.00

Jones and Smith share profits and losses equally.

The above balance sheet shows the condition of the firm after liquidation. The only thing to be done is, first, to distribute the liquidation losses among the partners, and after this they will share in the net assets according to capital ratios. Accordingly, each capital account is debited with an equal share in the loss of $15,000, after which Jones' capital is $12,500 and Smith's account shows a debit balance of $2,500. This means that Jones not only gets the entire cash of $10,000, but Smith must contribute $2,500 to the firm and this also goes to Jones.

3. Personal Insolvency of One Partner

BALANCE SHEET OF SMITH, JONES & GREEN

Cash	$16,000.00	Smith, Capital	$15,000.00
Jones	9,000.00	Green, Capital	10,000.00
	$25,000.00		$25,000.00

Smith and Jones each have a 2/5 share and Green a 1/5 share in profits and losses.

The above balance sheet shows condition after taking into consideration the losses incident to liquidation. From this it is seen that Jones owes the business $9,000, but it is determined that he is personally insolvent and cannot contribute the share due from him. The net assets available for distribution consist of $16,000 in cash. Inasmuch as Jones' interest is entirely wiped out and a contribution is due from him which he cannot pay, the amount of that contribution is an additional loss to be borne by the two remaining partners. Their respective shares in this loss are determined by their original profit and loss ratios 2/5 and 1/5, so that as between themselves Smith must bear 2/3 of the loss or $6,000, and Green 1/3 or $3,000; after which Smith's capital and share in the net assets is $9,000, and Green's $7,000.

Distribution by Instalments

Where the process of liquidation is of long duration, the partners may desire to receive what is due them by instalments rather than wait till the end and receive their respective shares in one amount. Where the capital ratio is different from the profit and loss ratio, it is difficult to determine the proper ratio in which these instalments should be paid. This is due to the fact that all expenses and losses are not yet determined, and consequently it is impossible to tell what the ultimate ratios will be in which the partners are to share the net assets. The payment of instalments on an arbitrary basis might result ultimately in an overpayment of some partners and an underpayment of others. The only safe method of handling the situation is to pay the first instalments to those partners whose capital ratios are in excess of their profit and loss ratios until their capitals are reduced to the point where the capital ratios of all the partners are the same as their profit and loss

ratios. As soon as this point is reached, the proceeds of the assets may be distributed to the partners on the basis of their profit and loss sharing ratios, because these are now identical with their capital ratios. A more complete treatment of this problem will be taken up in the work of the second year under the discussion of the realization and liquidation account.

Treatment of Good-Will Upon Liquidation by Sale

When dissolution is brought about by the sale of the entire business, it usually happens that the amount realized on the assets is smaller than their book value, and the difference is treated as a loss in accordance with the principles previously stated.

Similarly, where the assets are transferred by sale and the price realized on them is larger than their book value, the excess constitutes a profit and must be distributed among the partners in profit and loss ratio. Usually such an excess is treated as a receipt on account of good-will, and two standard methods of booking it are employed. When good-will is mentioned in the sale contract and its value determined, it is brought on the books as an asset and transferred immediately to the partners' accounts. Thus, if the value is $15,000 and the profit and loss ratio is 2/5 to A, 2/5 to B, and 1/5 to C, the entry would be:

Good-Will	$15,000.00	
A, Capital		$6,000.00
B, Capital		6,000.00
C, Capital		3,000.00

Good-will is now shown as an asset, and the entry closing it off would be the same as for the sale of the other assets, viz., a debit to Cash and a credit to Good-Will.

On the other hand, when good-will is not specified as such in the sale contract, but the amount realized on the

sale of the assets is larger than their book values, this excess is credited to Good-Will, which is then treated not as an asset account (as in the case given above), but as a profit and loss account. The balance of this account is closed out to the partners' accounts in profit-sharing ratios in the same way as above. The ultimate result is the same in either case; the first method is a little more complete since it shows possession of the asset good-will previous to its sale.

The formal entries by which the sale of any business is recorded on its books, whether single proprietorship, partnership, or corporation, are treated in Chapter XLIX under Corporations.

Practice Data*

(Assignment for Chapter XLIV)

Close the books, through the Journal, for the six months ending June 30, 1917, taking account of the following adjustments and inventories:

Accrued Expenses—salesmen's salaries $2,070; shipping clerks $200; board of horses $50.10; blacksmith bill $15.25; advertising $500; freight bills $150.25; light and power bills $106.21; bookkeepers, stenographers, billing clerks, etc. $125; office expense $5.25; janitor and watchman $90; interest accrued on Ward's loan $12.50.

Prepaid Expenses—July rent $250; insurance $418.40; membership in Credit Men's Association, $37.50; interest on note held by Van Dusen Co. $5.83.

Accrued Income—Interest on I. B. Perkins' note, 45 days, $15; interest on A. M. Tuttle's note, 37 days, $15.42; interest on Lewiston Bonds, 1 month 6 days, $12.

Write off the J. Jackson account to Bad Debts on account of his absolute bankruptcy.

Out-freight for June is $182.63.

Charge depreciation as follows:

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

10% per annum on store and office furniture and fixtures.
16 2/3% per annum on horses, wagons, and harness, except on the last purchase of $750, on which charge no depreciation.

Set aside 3% of the outstanding accounts as a reserve for doubtful accounts.

Inventories were: merchandise $16,497.23; packing materials $105.20; office supplies $75.18.

Lewiston School Bonds are valued at par.

Upon appropriation of profits, take account of the agreement as to salaries and excess drawings. For interest calculations, assume that drawings are made on the last day of the month.

Instructions

Bring the adjusting entries onto the Journal and post them. Then draw up the statements as required in the next Practice Data for Chapter XLV and close the books using the profit and loss statement for a guide. Use Chapters XXX, XLII, XLIII, and XLV for reference as to summarizing the period's results.

CHAPTER XLV

TYPES OF ACCOUNTING RECORDS AND THEIR DEVELOPMENT

Evolution of Analytical Journals

The only books absolutely necessary for an accounting record under the double-entry method are a journal and a ledger. However, even the small business finds some subdivision of the journals advantageous, and so makes use of sales, purchases, and cash receipts and cash disbursements journals. As a business grows and its transactions increase in volume and complexity, further subdivision is needed. As the scope of its organization becomes too great for any one man to exercise a personal oversight, a method or system must be devised for keeping the proprietor or manager in close touch with the various departments and lines of business endeavor. This is accomplished by means of reports from the accounting department, which exists largely for the purpose of furnishing this kind of information.

Principle to be Followed in Securing Analysis

In an earlier chapter it was laid down as a fundamental principle that wherever information of a particular kind is desired by the management, the accounting department should be in a position to furnish it by means of analytical records made at the time of original entry, rather than by analyzing a composite record at the time the information is wanted. Such analytical records make possible a quicker and more up-to-date report to the management,

and they save labor in securing the information by making the analysis at the time of record when all the facts related to it are readily available.

Subdivision of the Ledgers

The next step in subdivision of the records is made in the ledgers. The general or impersonal accounts of the business are of a more permanent character than the accounts with persons. Consequently, when once it is determined under what account titles information is desired by the business and those accounts are set up, there is usually little need for afterwards changing these titles. With personal accounts, however, there is constant change. Some customers are lost and new ones are constantly being added. We cease dealing with certain creditors and make our purchases in new markets. Accordingly, this was the basis for the first subdivision of the ledgers. The accounts with customers were placed in a separate ledger called variously the sales, customers, or accounts receivable ledger, and those with creditors in a separate ledger called purchase, creditors, or accounts payable ledger. All other accounts were kept in the main ledger known as the general ledger. One advantage of this subdivision was that several bookkeepers could work on the various ledgers at the same time.

Further subdivision of the customers ledger is frequently made into "city" and "country" ledgers, the former containing all accounts with customers located within the city where the business is situated, and the latter containing all out-of-the-city accounts. Other subdivisions may be made on an alphabetical basis, i.e., customers ledger No. 1 containing all accounts from A to G; No. 2, H to M, etc. Sometimes the concern's sales territory is divided into arbitrary districts and the ledgers

are subdivided to correspond with such districts. The next step in the interest of efficiency within the accounting department was the introduction of a method to secure a separate balancing of each ledger. This is explained in the next chapters on the controlling account.

Types of Sales Journals and Methods of Handling

The subdivision of the general journal into separate journal books is one step towards analyzing the journal record, and this is carried still further by introducing so-called columnar journal records. Reference has already been made, in Chapters XX and XXXIX to the use of additional columns in the sales book. Here a brief sketch will be given of the methods of recording sales in the various kinds of sales journals.

1. One kind of sales journal, not often used now, consists of an impression book with columns for the extension of the amounts and sometimes with additional columns for purposes of analysis. This is similiar to the old letter impression book and each sheet contains the press copy of invoices sent to customers. The method has the advantage that the entry in the sales journal is an exact copy of the invoice. Oftentimes, however, the impression is poor and nearly or quite illegible, it takes much room, the detail shown is not often used, and it increases the work of making and handling the record.

2. Another method makes use of a perforated invoice book with a columnized inter-leaf solid-bound between the perforated invoice sheets. The sales invoice is written on one of the perforated sheets and a carbon underneath gives a duplicate on the inter-leaf, the latter constituting the formal sales record. The advantages and objections are practically the same as for the impression book method.

3. Another method makes a separate carbon copy for each invoice and this duplicate is the source of entry in the sales journal. The journal entry gives only the file number of the duplicate invoice so that in case of need the duplicate can easily be referred to. This sales journal may, of course, be analytical under any desired heads.

4. Still another method uses the duplicate invoice for posting to the customer's account after which it is filed in binders. The latter are usually provided with recapitulation sheets which show the totals and analysis for each day, week, or month as the case may be. Just as above, the invoice file provides the detail in support of the ledger account and the recapitulation sheets are the journal from which credit to the various sales accounts is made. Either one of these last two methods eliminates most of the objections and embraces most of the advantages of the other methods mentioned above.

Where several sales ledgers are used, the sales journal is sometimes subdivided on the same basis as an aid in posting, and for the purpose of securing controlling figures as explained in the next chapters.

The Sales Returns and Allowances Journal

Wherever an analytic sales record is made, a similar record must be made of sales returns and allowances as explained in Chapter XXXIX. A separate book, exactly similar in form to the sales journal, is employed for recording these items. Sometimes the pages in the back of the sales journal are used instead of the separate book.

Posting the Sales Journal

In the posting of these various forms of journals no difficulty should be encountered. The total sales is credited to the Sales account in the general ledger, or,

where analysis is made, credits are to the various sales accounts as shown by the totals of their respective columns in the sales journal. The individual sales items are posted to the debit of the customers' accounts or to cash, as the case may be. This is also done where controlling accounts are used, but, in addition, the total for all postings to customers is debited to the customers' controlling account in the general ledger.

Development of the Purchase Journal

The purchase journal has had a similar development from the old-time scrap-book for invoices to the highly analytic voucher record used in some lines. The old-fashioned invoice book was usually a big, loose-bound, coarse paper volume in which were pasted the purchase invoices for goods bought. An extension column was provided for the amount of the invoice, and the total of this gave the purchases for a given period. This was developed along analytic lines by providing additional columns for various classes of purchases. It was a cumbersome, nondescript, unkempt record, and gave place to the formal purchase journal or register.

The purchase journal or register is made up of regular account paper ruled to suit individual needs and purposes. Where analysis of the sales is made into separate classes, an exactly similar analysis of purchases must be made to secure a gross profit figure for each class. Therefore, its form will follow very closely that of the sales journal. Entry of the invoice is made in the purchase journal as to name, terms, and amount, also giving the number of the file where the invoice can be found in case of need.

Where a separate purchasing department is maintained, the duplicate orders, corrected if necessary to cor-

respond with the purchase invoice received, might be used as the basis of the purchase journal. In this case recapitulation sheets are inserted just as with the sales journal. The handling of purchases is not so complicated as that of sales, because purchases usually are much smaller in number than sales. Posting of the purchase journal follows the general lines of the sales journal and the same general considerations apply to the handling of returned purchases as to returned sales.

Handling Expenses Through the Purchase Journal

Frequently expenses of all classes are regarded as regular purchase transactions and are classified as labor, rent, salaries, supplies, etc. Under this method the entry is not postponed until the item is paid, but is made at the time of securing the service or supplies. The basis for the entry may be the bill or purchase invoice received, or simply the knowledge that the expense is incurred with no formal paper to vouch for it. Some concerns make up a formal purchase memo for every transaction of this kind and use that as the basis for the entry. This is the voucher record method which will be treated in the second volume, but the following outline of it will be given here:

Where expense invoices are entered and analyzed in the purchase journal, posting of such requires debits to be made to the various expense accounts and credits to the individual creditors' accounts in the ledger. In case the ledger contains only a controlling account, it is credited for the total of the expense and other purchases, but the individual accounts in the creditors ledger must be credited also. When the bill is paid, entry in the cash book will not be, as usual, to the debit of the expense account, but to the debit of the creditor's account.

The entry of expense invoices in this manner secures

an immediate record of all such liabilities, and therefore makes the books show full liabilities at all times for these expense items. However, it necessitates a little more work in making the record, and this is why many concerns never enter expenses until paid, making the debit to them through the cash book. In this latter case all unpaid expense bills should be kept in an expense file for reference whenever the information as to liability on outstanding expense accounts is desired.

Note Journals

As explained in Chapter XXXVIII, note journals are sometimes used. At posting time proper analysis must be made in order to distinguish between notes from customers and notes from other sources as explained in Chapter XXXVIII.

Analysis in the Cash Book

The cash journals may have any desired analysis. On the debit side, i.e., the cash receipts journal, analysis may be made to show all sources of receipts, and on the credit side to show all the objects of expenditure. This may be very detailed, the only limit to columnar analysis being the width of the page. A greatly detailed analysis is not usually made through the cash journals. Where the expenditures analysis is desired, it is usually made in the purchase or voucher record which thus relieves the cash book of a mass of detail.

The sources of cash receipts are usually more limited than the objects of expenditures, and do not therefore require so much analysis. The chief advantage of using additional columns in books of original entry lies in the fact that time and labor are saved in posting. The column total is posted in one item, whereas each of the numer-

ous items composing it would have to be posted in case no analytical column was provided. Hence, it would be a waste of paper to provide separate columns for items which recur not oftener than once a week or once a month. Care should be taken always to avoid needless columnization. It is customary to have the following columns on the debit side of the cash book: General or Sundry, Accounts Receivable, Sales Discount, and "Net Cash or Bank"; on the credit side: General or Sundry, Accounts Payable, Purchases Discount, and "Net Cash or Bank." The proof of the distribution is secured by checking the sum of the net cash and discount columns against the sum of the totals of the other columns. Every item of both receipts and disbursements must appear in the "Net Cash" column, from which distribution is made. Receipts from customers are distributed into the "Accounts Receivable" column for the gross amount of the item, and into "Sales Discount" for the discount, if any is taken. All other items are carried into the "General" or "Sundry" column. Where several sales ledgers are kept, additional columns may be provided so that instead of having one accounts receivable column, there are columns for each of the separate ledgers. Similar treatment is given to the disbursements.

Analysis in the General Journal

Where the general journal is used for returned goods, allowances, and other adjustments with customers and creditors, use is made of analytic columns with these captions for both the debit and credit: Accounts Receivable, Accounts Payable, and General. Here, however, there is no column in which every item must be entered and from which it is distributed to the other columns. If a customer's or a creditor's account is affected, entry is made in that column in the first place. All *other* entries are in

the general column. The student should refer to Chapter XXII for the illustration.

With regard to analysis columns in the general journal, some accountants maintain with good reason that if the number of transactions of a particular kind is sufficiently large to justify their segregation into a separate *column*, this in itself would be ample justification for the use of a separate *journal* to record these items. Whenever the analysis in the general journal requires an ever increasing number of separate columns, it is a matter of discretion with the accountant when to open a new journal for the record of such items as appear there most frequently.

Practice Data*

(Assignment for Chapter XLV)

Draw up a pro forma statement of profit and loss and a balance sheet for Ward & Gneisel for the six months. In drawing up the balance sheet, head it as follows:

Exhibit A
Ward and Gneisel
Balance Sheet, June 30, 1917

Show the total of all customers' accounts as "Accounts Receivable (see Schedule 1)." Attach to the balance sheet a list or schedule of all customers' accounts to support the title "Accounts Receivable (see Schedule 1)" carried in the balance sheet. Give to it as a formal heading:

Exhibit A—Schedule 1
Ward and Gneisel
List of Accounts Receivable, June 30, 1917

Attach schedules also for the other group items appearing in the balance sheet viz.: Deferred Charges to Operation, under which include in addition to the other items listed, the office supplies and packing materials still on hand; Accrued Income; Accounts Payable; and Ac-

crued Expenses. This method relieves the balance sheet of much detail and renders it more intelligible; also the detail is available if desired.

In drawing up the profit and loss statement refer to the forms already shown, following particularly the chart of temporary proprietorship accounts shown in Chapter XXXI. The "Miscellaneous Sales" item should be added to the Net Sales short extended, and their total should be full extended, from which should be deducted Cost of Goods Sold as usual. Show fully the appropriation of profits.

As a matter of convenience in marking the blanks, record these statements and schedules on the last few pages of the cash book.

*Practice Data for Ward & Gneisel set begin with Chapter XXXI.

CHAPTER XLVI

CONTROLLING ACCOUNTS

Introductory

Reference has been made several times in previous chapters to controlling accounts. It is purposed now to define them and explain their use. The separation of the various journals on the basis of an analysis of transactions has been seen to free the general journal of a vast mass of detail formerly carried by it. This separation, however, in no way affects the underlying debit and credit scheme of the whole system. Each journal is an integral part of the whole; every entry therein has its equal debit and credit which is in due course posted to the ledger; and thus is the equilibrium of the ledger maintained. The separation of the ledger into three or more subsidiary ledgers in the interest of economy of effort and ease of use has also been mentioned. Still, each of these subsidiary ledgers is an integral part of the whole ledger and must be taken in to secure proof of equilibrium. The customers ledger is usually the most active of the various ledgers, i.e., more postings are made in it because the majority of business transactions involve dealings of various sorts with customers, and more accounts are required to keep the records with customers. It is usually, therefore, the largest part of the whole ledger, but its accounts are all of the same kind, viz., accounts receivable. When taking a trial balance, the total of the balances of the customers ledger accounts may be set up under the title "Accounts Receivable," leaving the details for a supplementary list or schedule.

Advantage of a Controlling Account

The advantage of this shortening of the trial balance is apparent and suggests the desirability of obtaining the "accounts receivable" balance independently of the customers ledger. If this could be done, the bookkeeper in charge of the general ledger could not only get his trial balance without reference to the customers ledger but would also have the correct figure for the total of the account balances in the customers ledger. In other words, he would have a figure which controls the customers ledger and which would therefore furnish him with a check on the accuracy of the ledger clerk or bookkeeper who kept that ledger. The most convenient method of keeping record of this accounts receivable figure is evidently by means of a formal account on the general ledger. When such an account is kept, the effect is to make it a summary account whose detail is carried in the customers ledger.

Controlling Account Necessitates Changed Idea of Ledger Equilibrium

By having a customers controlling account in the general ledger, the customers ledger is deprived of its use as an integral part of the whole ledger and is reduced to a supporting schedule or list of detail for the summary controlling account. The equilibrium of the ledger is now secured by summary posting to the controlling accounts. The customers ledger has ceased to be a "ledger" in the proper sense of the term but it is still a vital part of the system, carrying as it does the detail of the summary controlling account, and it is linked up to the system by being provable against its summary account. Its scheme of debit and credit is now an independent one and is not linked up to the debit and credit equilibrium of the general ledger. Thus the mathematical basis of the controlling account is simply that

the whole is exactly equal to all its parts; the balance of the summary account being equal to the total of the balances of all the customers' accounts of which it is the summary. In other words, if we have customers' accounts whose balances are $1,000, $2,000, $3,000, $4,000, and $5,000 respectively, then the summary account must have a balance of $15,000.

Debits to the Controlling Account

The principle and the purpose of the controlling account having now been established, the next problem to be considered is how best to gather the summary figures for its debits and credits. If every debit which is posted to some customer's account must be posted also to the controlling account and every credit to a customer's account must be shown as a credit in the controlling account, the work involved would be almost doubled. Therefore, it is of importance to secure these figures with the least effort, i.e., in the form of summaries. In order to determine the sources of the various debits and credits of the controlling account, analysis must be made of the sources of the debits and credits to the customers' accounts.

Most of the debits to customers' accounts are from the sales journal. Additional debits may be from the cash disbursements journal in case of a cash payment by way of rebate, refund for overpayment, or other similar transaction; and from the general journal for adjustments of various kinds. The debits to customers for cash paid them are very few in number, because adjustments usually are not made by means of cash payments. The sales journal, as usually operated, carries a column for credit sales, whose total represents in one amount the total of all detailed debits to customers' accounts. The total of the credit sales column, therefore, controls the total debits to all customers on account of charge sales to them. The controlling account in

the general ledger is variously termed "Sales Ledger," "Accounts Receivable," "Trade Debtors," "Customers," etc. In summarizing the sales journal it should be shown in the summary entry that this total is to be posted not only to the credit side of the Sales account but also to the debit of the controlling account in the ledger. This is so because the customers ledger has ceased to be an integral part of the general ledger, the controlling account having taken its place.

Where the total sales in the sales journal includes both cash sales and credit sales, the following summary entry should be made:

Accounts Receivable
Cash
    Sales

The cash debit is set up only to show the equilibrium of the summary entry and is not posted because entered also in the cash book. This debit posting to "Accounts Receivable" account in the general ledger secures in one posting a debit amount equal to all individual debit postings to the customers ledger from this source.

The two other sources of debit posting to customers' accounts are the journal and the cash book. The debit side of the journal, for this purpose, is provided with an accounts receivable analysis column in which, as explained in the previous chapter, every debit to a customer's account is entered. At posting time, the total of this accounts receivable column will therefore give in one figure a debit posting item to the general ledger Accounts Receivable account equal to all individual debit postings from the general journal to customers' accounts in the customers ledger.

Usually it is not necessary to provide an accounts receivable column on the credit side of the cash book, since debit postings from there to customers' accounts are very

infrequent, and hence no total or controlling figure for entry in the Accounts Receivable account can be obtained. Every item which is posted from this source to the debit of a customer's account must be also posted—item by item—to the debit of Accounts Receivable in the general ledger. This is, of course, a double debit posting, but one of these debits is to a subsidiary ledger which is no longer a part of the equilibrium scheme and therefore does not throw the general ledger out of balance. Great care must be exercised to make sure that each of these items is posted both to a customer's account and also to the Accounts Receivable account.

Credits to the Controlling Account

An analysis of the credits to customers' accounts shows four main sources: (1) the cash receipts journal for payments made by customers; (2) the sales returns journal, if one is kept, for goods returned by customers; (3) the note journal for notes received in payment; and (4) the general journal for various adjustments and also for the purpose of recording notes and returned sales where special journals are not kept for these transactions.

Accordingly, analytic columns for accounts receivable are provided in the cash receipts journal and the general journal. The totals of their columns are posted to the credit of Accounts Receivable, and the detailed amounts to the credit of the various customers' accounts. The credit postings from these sources to the customers ledger accounts and to the general ledger Accounts Receivable account are therefore the same as far as totals are concerned. The sales returns journal is summarized at posting time by means of an entry similar to that in the sales journal entry, as follows:

Sales Returns
        Accounts Receivable

In this case the credit posting to the Accounts Receivable account is equal to the detailed credits to customers' accounts.

Similarly, a summary entry for the notes receivable journal secures a controlling figure for Accounts Receivable. If the notes are all received from customers to apply on their accounts, the summary entry is:

Notes Receivable
    Accounts Receivable

the amount being the total of that journal.

In this way the total of all debits and of all credits to the individual customers' accounts is represented by the summary items entered in the general ledger controlling account, Accounts Receivable. Consequently, the balance of this single account is equal to the balance of the customers ledger. For the trial balance, therefore, one account takes the place of hundreds or even thousands of customers' individual accounts. As a result of this much time is saved and the possibility of error on the general ledger greatly reduced.

Proving the Customers Ledger

This, however, does not eliminate the necessity of proving the accuracy of the customers ledger. It merely makes it possible to take a trial balance without bringing the numerous customers' accounts into it. It is just as much a part of the proof of the work to make a list of customers' accounts balances and check it against the balance of the Accounts Receivable general ledger account, as it is to prove the general ledger by means of a trial balance. If there is discrepancy between the subsidiary ledger and its controlling account on the general ledger, that discrepancy does not necessarily prevent a trial balance of the general ledger, but

it does show error in the work which must be searched out and corrected.

Accounts Payable Account

A similar arrangement will make possible a controlling account on the general ledger for the creditors or purchases ledger. This account is variously termed Accounts Payable, Purchase Ledger, Creditors, or Trade Creditors Account. Its mechanism is the same as for Accounts Receivable. Analysis of credit postings to creditors' accounts shows the purchase journal as their main source. Other credits come through the general journal and a very few through the cash receipts journal. The summary entry for the purchase journal is:

Purchases
  Accounts Payable
  Cash

This shows a debit to the Purchases account for the total amount of the purchases, a credit to Accounts Payable for liability to creditors, and to Cash for the amount paid on cash purchases. The cash item is not posted. The "Accounts Payable" column total on the credit side of the journal, and the separate items from the cash receipts journal, furnish the other credits to the Accounts Payable account in the general ledger.

The debits come from the "Accounts Payable" columns in the cash disbursements journal and in the general journal, and the summaries for the notes payable and purchases returns journals.

Basic Principle as to Postings to Controlling Accounts

In the handling of all controlling accounts, the one fundamental requirement is to make sure that every entry in

books of original entry which affects any account in the subsidiary ledger is reflected in the postings to the controlling account in the general ledger. This principle resolves itself to the mathematical axiom stated above that a whole is equal to all—not just some—of its parts. Only thus can a true control be established.

Making the Subsidiary Ledger Self-Balancing

Using the two controlling accounts explained above, the trial balance is relieved of a large number of accounts, and the general ledger is made independent of the subsidiary ledgers. On the other hand, the subsidiary ledgers are dependent for their proof on the controlling account balances in the general ledger. In an effort to make every ledger "self-balancing," a further refinement of the controlling account idea is frequently incorporated in each subsidiary ledger. It is accomplished in the following manner: An exact duplicate of the controlling account on the general ledger is set up in the subsidiary ledger, *with this difference,* that the sides of the account are reversed so that the subsidiary ledger account has for its debits the credits of the general ledger account, and for its credits the debits of the general ledger account.

Take the accounts receivable controlling account for illustration. On the general ledger its balance is, of course, a debit balance representing the total outstanding accounts due from customers. Similarly, the schedule or list of customers' accounts taken from the sales ledger will represent debit balances whose total is the same as the controlling account balance. If, then, the controlling account itself is placed on the customers ledger as an additional account, the sides being reversed, the balance of this one account will be a credit equal to the total debit balance of all the other accounts in the customers ledger. Therefore, if the cus-

tomers ledger is correct its own balance will be offset exactly by the credit balance of the one additional account, and the ledger then is said to be self-balancing. There is no theory or principle of debit and credit involved in this; the device is simply introduced in order that the ledger may provide an internal proof of its correctness. The title of the balancing account on the subsidiary ledger is "Adjustment" or "Balance" and has no significance other than that mentioned. In a similar manner any subsidiary ledger may be made self-balancing.

Problem

(*Assignment for Chapter XLVI*)

A partnership agreement provides that before net profits shall be determined, the partners shall be charged with 6% interest on their "personal" withdrawals from the dates of such withdrawals to the date of closing the books and that net profits shall be divided in proportion to the net "capital" investments and the length of time of their investment. The profits before taking the above into consideration were $3,569.72 and the partners' combined capital and personal accounts show as follows:

A. K. Avery

1917			1917		
Jan. 20	Capital	$5,000.00	Jan. 1	Capital	$10,000.00
Feb. 28	Personal	300.00	Feb. 15	Capital	2,500.00
April 10	Capital	3,000.00	May 10	Capital	5,000.00
June 10	Personal	250.00			

C. E. Clarence

1917			1917		
Feb. 1	Personal	$250.00	Jan. 15	Capital	$5,000.00
Mar. 15	Capital	7,500.00	May 20	Capital	5,000.00
May 31	Personal	300.00	June 10	Capital	5,000.00

If the books are closed on June 30, 1917, what is each partner's share of the profits?

CHAPTER XLVII

HANDLING CONTROLLING ACCOUNTS

Chapter XLVI concerned itself with the statement and explanation of the principles on which the controlling account rests, the manner of its make-up, its advantages, and with the changed application of the fundamental scheme of debit and credit under a system of records operating controlling accounts. The present chapter will be devoted to a consideration of the problems met with in the practical operation of these accounts.

Introduction of the Controlling Account

Upon the installation of a new system or set of books, the controlling account feature may be incorporated from the start. The new system must provide for the separation from the general ledger, of the ledgers over which control is to be established. In order to secure controlling totals for posting to the general ledger controlling accounts, the detailed postings to the subsidiary ledgers must be summarized, and this is accomplished through the use of special analytic columns.

Where it is desired to introduce the controlling account features into a system which has not formerly used it, certain adjustments must be made, i.e., the accounts to be controlled must be segregated and controlling account columns must be provided for in books of original entry. With the transfer of these accounts to a separate ledger, together with the introduction of the controlling accounts into the general ledger, the equilibrium of that ledger is

maintained. The opening entry in the newly established controlling account is, of course, the sum of the balances of the transferred accounts.

If it is desired to establish the new controlling account by journal entry, that entry would appear somewhat as shown on page 429, with a suitable explanation added. All these items should be posted to the general ledger just as shown by the entry, and, in addition, the detailed items should be posted as debits to the accounts in the customers ledger. The effect of these postings would be, first, to close the individual customers' accounts formerly carried in the general ledger and open up in their stead the controlling account, and, second, to set up on the subsidiary ledger the detail of the customers' accounts.

Recording Withdrawals of Stock in Trade

The original basis for separating the main journal into its subsidiary parts was the analysis of all transactions according to their various kinds, such as sales, purchases, cash, etc. The sales journal was presumed to contain only sales of stock in trade. Departure from this principle was advisable in the case of goods drawn at cost, for use in the business, for the proprietor's personal use and for other similar purposes. This is done because all withdrawals of stock in trade, at whatever price and for whatever purpose, have their easiest record in the sales journal.

It is theoretically incorrect, however, to enter such items in the Sales account because withdrawals at cost do not represent actual sales, and for this reason should be regarded as deductions from purchases or from inventory. The only place for their record, under this view, is the general journal, entry in which would have to be by detailed debit and credit for every such entry. However, this would require much more work than entry in the sales journal.

Usually the volume of such transactions is not large and would not seriously vitiate the use of the Sales account as the basis for estimating percentages of cost of goods sold, gross profit, selling expenses, etc. Moreover, the total amount of these withdrawals usually is fairly constant as between periods. Hence, record in the sales journal of items of this nature is countenanced.

The Problem of the Sales Journal Summary

However, when withdrawals from stock at cost price are recorded in the sales journal, a new problem arises in summarizing the sales journal when operating under a controlling account system. The customers or sales ledger is usually limited absolutely to customers' accounts. Accounts with the proprietors, and with all other titles under which withdrawals may be recorded, are almost invariably carried in the general ledger. Therefore, while most of the items entered in the sales journal are posted to the customers ledger, these withdrawal items must be posted in detail to the general ledger. Thus the total of the sales journal does not represent the correct debit to accounts receivable in the general ledger. Evidently an analysis of the content of the sales journal must be made in order to obtain the correct controlling figure. Such analysis may be made in several ways. Where possible, three columns in addition to the departmental columns should be used. The column titles would be "Sales Ledger," "Cash," and "Sundry." The sum of these three would give the total to check against the total of the other distributive columns, but only the "Sales Ledger" total would be posted to Accounts Receivable, and the individual items in that column would be posted to the customers' accounts in the sales ledger. The items in Sundry column would be posted to their named accounts in the general ledger. This method secures an

automatic separation of the controlling account total from other items, and should be used where possible.

If the number of these extraneous items is too small to warrant the use of a separate column, they may be recorded in the Sales Ledger column and indicated by means of an "X" or other mark. At summary time, the sales journal must be looked over and these items picked out. Subtraction of their sum from the Sales Ledger column total would give the correct controlling account posting.

Still another method requires a correcting general journal entry at the time the sales journal entry is made. Under this method these special items are included in the Sales Ledger column, thereby causing an overcharge to Accounts Receivable. The correcting general journal entry must therefore credit Accounts Receivable by the amount of the overcharge for each item. For instance, if stock has been drawn by the proprietor, the general journal entry at the time the sales journal entry is made would be:

Proprietor, Personal
    Accounts Receivable

the debit to proprietor being checked here and posted from the sales journal or vice versa. This method, however, results in a duplication of work. It would be preferable not to enter these items in the sales journal and to make the record only in the general journal, and so leave the Sales Ledger column total in the sales journal the correct controlling figure.

The Problem of the Purchase Journal Summary

The practice of recording extraneous transactions in the purchase journal brings about at summary time a situation similar to that of the sales journal, when a controlling Accounts Payable account is maintained. The purchase

journal is and should be the place of record for purchases made for the business. If the proprietor (or other person), for his personal account and use, purchases through the business merchandise which never goes into stock, accurate accounting requires that such transactions shall be charged direct to the proprietor and not to the purchases account of the business. Inasmuch as the liability here is assumed by the business and the creditor's account will appear in the purchase ledger, the use of the purchase journal total for credit to the Accounts Payable controlling account gives the correct figure. The trouble comes in because this same figure cannot be used as the debit to Purchases. Subtraction of these extraneous items must be made to determine the proper amount chargeable to the Purchases account, thus necessitating an analysis at summary time.

Accounts Both Receivable and Payable

It frequently happens that purchases from, and sales to, the same party are made, i.e., goods are sometimes bought from a customer and goods are sold to a person who is normally a creditor. If the account is normally a purchase account, it is set up in the purchase ledger. If a sale is made to this creditor and charged to his purchase ledger account, such transaction should not be included in the Accounts Receivable controlling figure from the sales journal unless an adjusting entry is made through the general journal. Such entry would affect only the controlling accounts and would be:

Accounts Payable
    Accounts Receivable

Or the item might be omitted from the sales journal controlling figure and stated separately in the summary entry for the sales journal.

A more satisfactory method is to set up two accounts with such parties—one as a creditor, the other as a customer. Then no adjustment need be made at the time of summarizing the journals, because the two accounts are treated as entirely independent of each other. The settlement of these two accounts may be handled separately or by a payment of the balance between the two. If settled by balance, an adjusting journal entry should be made to show on the books the two separate elements involved. This again would affect only the controlling accounts.

The Problem of the Note Journals Summaries

Of notes receivable the large majority are usually received from customers. The summary entry for such is:

Notes Receivable
        Accounts Receivable

Where notes are received from other sources as from officers, partners, or from outside parties to whom loans have been made, it is evident that these must not be included in the credit to Accounts Receivable, and it may be advisable also to eliminate them from Notes Receivable unless they are short-term, current items, as only such should be carried under Notes Receivable. These special notes may be carried in a "Notes Receivable Special" account.

If, as sometimes happens, interest is included in the face of a note, this must be adjusted by the summary entry, as follows:

Notes Receivable
        Accounts Receivable
        Interest Income

The considerations stated above as applicable to the notes receivable journal are of equal importance in handling the

notes payable journal. A very careful analysis of the note journals should be made at a summary time, which analysis should be shown by the summary entry.

Summary Entries for Columnar Books

Illustration will now be given of some standard forms for summarizing the columnar journals. Sometimes the summary entries for the various subsidiary journals are made in the general journal. This seems to accomplish no good purpose and is not usually recommended. With regard to all summary entries, theoretically it is desirable to show a formal debit and credit summary for each journal. If, however, the number of columns is small and it is readily seen that the debits and credits are equal, the formal summary is often dispensed with. So also, if there is a large number of distributive columns of the same effect, i.e., debit or credit, as in the large departmental sales journal or the voucher register referred to on page 408, formal summary is not shown, the posting being made from the column totals as illustrated for Petty Cash on page 292.

The Sales Journal Summary

An illustration of the sales journal summary is given on page 429. The Sundry items should be posted in detail from their column and their total checked in the summary entry. Where a Sundry column is not used but these items are included in the Sales Ledger column, they must be separated before the summary entry can be made. Where, also, a Cash column is not carried, as is so often the case, there being just one column for Sales Ledger, Cash, and Sundry items, from which distribution is made, the separation of the Cash items need not be shown in the summary entry, provided those items are entered also in the Sales Ledger column of the cash book. The overcharge to sales ledger

Accounts Payable	Accounts Receivable	General	Date		L. F.	General	Accounts Receivable	Accounts Payable
		15,000.00		Accounts Receivable				
				A (customer)		2,500.00		
				B "		5,000.00		
				C "		4,000.00		
				D "		3,500.00		

Columnar Journal

		Sales Ledger	Cash	Sundry	A	B	C
		(Detailed entries appear in this space)					
Totals		25,000.00	75,000.00	750.00	30,500.00	25,250.00	45,000.00
Accounts Receivable		25,000.00					
Cash		75,000.00					
Sundry		750.00					
Dep't A, Sales			30,500.00				
" B, "			25,250.00				
" C, "			45,000.00				

Sales Journal Summary

Accounts Receivable	Accounts Payable	General	Date			L. F.	General	Accounts Receivable	Accounts Payable
					(Detailed entries appear in this space)				
		10,250.00					8,050.00		
1,500.00	5,000.00	1,500.00	Dec.	31	Accounts Receivable			1,200.00	7,500.00
		5,000.00			Accounts Payable				
					Accounts Receivable		1,200.00		
					Accounts Payable		7,500.00		
		16,750.00			To close		16,750.00		

General Journal Summary

from the sales journal summary will then be exactly offset by an equal overcredit from the cash book. Where, due to the large number of distributive columns, the sales journal can ill afford the room for a Cash column, the above method offers the best solution of the problem.

The purchase journal summary is similar to that of the sales journal, and therefore no separate illustration is given here.

The General Journal Summary

As shown by the illustration on page 430, the Accounts Receivable and Accounts Payable columns are formally totaled, ruled off, and their totals brought into the General columns on both debit and credit sides and these columns are totaled and ruled off, thus showing the equilibrium of the journal. This summary entry is posted to the proper accounts in the general ledger. There is no particular advantage, however, in this formal summary entry because the postings could easily be made directly from the column totals.

The Cash Book Summaries

As illustrated on page 432, the formal summary for the cash book on each side shows the equality of the Bank and Discount columns total against the General and Accounts Receivable and Payable columns. To develop the correct debit to the bank for the present month, the balance brought forward from last month must be subtracted. As that was entered in both the General and Bank columns on December 1, it must now be subtracted from both.

On the disbursements side no explanation of the summary entry is necessary. It will be noted that, in order to show the balance of the bank account, a re-stating of the Bank column total is necessary.

Date			L. F.	General	Accounts Receivable	Sales Discount	Bank
Dec.	31	Totals		13,050.00	41,250.00	1,800.00	52,500.00
		Balance Dec. 1,		5,000.00			5,000.00
				8,050.00			
		Bank, Dr.					47,500.00
		Sales Discount, Dr.					1,800.00
		Accounts Receivable, Cr		41,250.00			
				49,300.00			49,300.00
Jan.	1	Balance		11,350.00			11,350.00

Cash Book Summary—Receipts Side

Date			L. F.	General	Accounts Payable	Purchase Discount	Bank
Dec.	31	Totals		8,000.00	37,500.00	4,350.00	
		Bank, Cr.					41,150.00
		Purchase Discount, Cr.					4,350.00
		Accounts Payable, Dr.		37,500.00			
				45,500.00			45,500.00
		Bank, as above					41,150.00
		Balance					11,350.00
							52,500.00

Cash Book Summary—Disbursements Side

Other Controlling Accounts

It is frequently desirable to keep some accounts of the business private, such as those showing partners' investments, drawings, ratios of sharing profits, and the adjusting and closing entries, the profit and loss, etc. This can be accomplished through the use of a private ledger supported by a private journal and sometimes a private cash book. For their operation a controlling account of the private ledger is set up in the general ledger, and, similarly, a controlling account of the general ledger in the private ledger. The use of private books is explained in Volume II of this work. Sometimes subsidiary expense ledgers are used to carry a minute division of each expense group, and then corresponding controlling accounts, such as Selling Expense, Office Expense, General Expense, Factory Expense, etc., are carried on the general ledger.

Similarly, if the consignments activity of a business is large enough to justify a separate record in a consignments ledger, a controlling account is set up in the general ledger. In a manufacturing business, Raw Materials, Goods in Process, and Finished Goods accounts are often controlling accounts for the stores, jobs, and finished stock ledgers. In a corporation, the Capital Stock account (or accounts) is a controlling account over the stock ledger.

Principle Governing Content of Subsidiary Ledgers

Before closing this chapter, it should be stated that, as a fundamental principle, no accounts should be carried in a subsidiary ledger except such as are of the same general kind and can without misrepresentation be carried under the group title of the controlling account.

Practice Data

(*Assignment for Chapter XLVII*)

This set comprises a general journal; a sales journal, a sales returns and allowances journal, a purchase journal, a purchase returns and allowances journal, and the cash journals, for convenience bound together in one book; a note journal to be used as a posting medium for notes receivable and notes payable; and a general ledger, a purchase ledger, and a sales ledger bound together in one book. Of the subsidiary journal blank, page 1 is for the sales journal, page 2 the sales returns, page 3 the purchase journal, page 4 the purchase returns, and pages 6-9 the cash journals. Of the ledger blank, pages 1-15 will be used as the general ledger, pages 16-19 the sales ledger, and pages 20-22 the purchase ledger. The general journal will be used as previously; i.e., for the record of all items not otherwise specially provided for; the sales journal provides for analysis of the sales, the first column being the total or general column, the others, Dept. A, Dept. B, and Out-Freight, respectively; the sales returns and allowances journal makes provision for the same analysis as the sales journal except that there is no "Out-Freight" column, that not being used; the purchase journal columns are respectively, Total, Dept. A, Dept. B, and In-Freight, with the same column headings for the purchase returns and allowances journal. The cash book columns will be, on the debit, General, Sales Ledger, Sales Discount, and Bank; and on the credit, General, Purchase Ledger, Purchase Discount, and Bank. The note journal will be analyzed, summarized, and posted just as the other subsidiary journals are handled.

Daily posting of items affecting customers' and creditors' accounts should be made, observing carefully terms of credit.

The purpose of the set is to give practice in handling various controlling accounts; the summarization and ruling of columnar books; and to bring out some of the difficulties involved in treating controlling accounts under given conditions. Record will be made of transactions for the last month of the fiscal year, the previous eleven months being summarized in the trial balance given to start with.

The Hardware Specialties Co. was organized and incorporated under the laws of the State of New York. Its fiscal year closes on November 30. A trial balance from the general ledger on October 31, 1916, shows as follows:

1	City National Bank	$ 5,250.69
1	Petty Cash	150.00
1	Notes Receivable	7,390.50

1	Sales Ledger	75,820.75	
2	Reserve for Doubtful Accounts		1,319.86
2	Reading Railway Stock	10,112.50	
2	Department A, Inventory	22,362.36	
2	Department B, Inventory	18,179.40	
3	Store & Warehouse Furniture & Fixtures	2,310.75	
3	Depreciation Reserves for Store & Warehouse Furniture & Fixtures		508.20
3	Office Furniture & Fixtures	850.25	
3	Depreciation Reserve for Office Furniture & Fixtures		170.30
4	Delivery Equipment	3,790.70	
4	Depreciation Reserve for Delivery Equipment		718.41
4	Buildings	46,210.00	
4	Depreciation Reserve for Buildings		1,470.75
5	Land	15,000.00	
5	Notes Payable		14,157.83
5	Purchase Ledger		55,094.31
5	Mortgage on Real Estate		10,000.00
6	Unissued Capital Stock	20,000.00	
6	Capital Stock		125,000.00
6	Surplus		44,862.19
6	Dividends Payable		
7	Profit and Loss		
8	Department A, Purchases	332,190.80	
8	Department A, Purchase Returns & Allowances		10,120.68
8	Department B, Purchases	295,780.19	
8	Department B, Purchase Returns & Allowances		9,876.20
9	In-Freight & Cartage	6,125.63	
9	Department A, Sales		401,675.35
9	Department A, Sales Returns & Allowances	7,392.15	
9	Department B, Sales		359,817.50
10	Department B, Sales Returns & Allowances	4,563.27	
10	Salesmen's Salaries	25,190.00	
10	Traveling Expenses	19,240.80	
10	Advertising	14,640.75	
11	Sales General Expense	4,870.13	
11	Out-Freight	216.13	
11	Insurance	5,760.20	
11	Office Expense	1,100.25	
12	General Expense	55,172.40	
12	General Salaries	29,275.80	

12 Interest & Bank Expense	1,250.18	
13 Sales Discount	12,769.80	
13 Bad Debts		
13 Depreciation		
13 Purchase Discount		8,174.80
14 Consignment, J. B. Grover		
14 Consignments-Out		
	$1,042,966.38	$1,042,966.38

Instructions

Open all the above accounts in your general ledger, at the places indicated, and enter under date of November 1 the balances given in the trial balance. The number in front of the account title indicates the page on which to enter the accounts. Give each one-fourth of a page, except on page 1, where give Sales Ledger two additional lines by shortening the space for Notes Receivable.

In the sales ledger, beginning on page 16, open the following accounts, four to a page, and enter the balances as of November 1:

Colonial Supply Co.	$ 1,250.60
Block Hardware Co.	2,100.10
Ted S. Class	1,780.90
Frank & Bros.	1,590.17
M. Shapiro & Co.	2,008.73
A. Mishkin	1,190.16
J. Kapner	2,317.69
L. M. Hoffman	1,670.80
B. F. Salzer	1,419.25
Lowell & Meservy	1,975.63
Builders Supply Co.	3,100.72
Sundry Customers	55,416.00
	$75,820.75

The "Sales Ledger" account on the general ledger controls this ledger.

In the purchase ledger, beginning with page 20, open the following accounts, four to a page, and enter the balances as of November 1:

American Hardware Supply Co.	$ 3,119.83
Mechanics Hardware Co.	2,567.20
Norton Door Check Co.	1,176.19

The Stanley Works	1,935.73
Simmons Hardware Co....................................	2,875.50
Dixie Lumber Co..	
Central Machinery & Supply Co........................	4,100.93
Griffen Manufacturing Co...............................	751.82
Sundry Creditors..	38,567.11
	$55,094.31

The "Purchase Ledger" account on the general ledger controls this ledger.

The two accounts, "Sundry Customers" and "Sundry Creditors" are used to secure volume of transactions without involving too great detail. They should be treated in all respects as personal accounts.

In the notes receivable journal, enter the following notes:

No. 57, made by Ted S. Class in our favor, for merchandise, dated August 5, 1916, for 3 months at 6%, amount $1,875.15.
No. 61, draft drawn by us on M. Shapiro & Co., dated September 25, at 60 days, amount $1.750.
No. 63, made by B. F. Salzer in our favor, for merchandise, dated October 1, at 6%, for 2 months, amount $1,765.35
No. 65, made by Builders Supply Co., in our favor, for merchandise, dated October 15, at 6% for 30 days, amount $2,000.

Enter these in the notes receivable journal, add them in the "Amount" column and rule it off as they are already posted in your general ledger "Notes Receivable" account.

In the notes payable journal, enter the following notes:

No. 15., made by ourselves in favor of the City National Bank for discount, dated September 23, at 8% for 60 days, amount $10,000.
No. 16, draft by Sundry **Creditors**, accepted by ourselves, dated October 13, for 2 months, amount $4,157.83.

Enter these in the notes payable journal and treat as with notes receivable above.

Your books, general and subsidiary, will now show the condition as at the beginning of business November 1.

CHAPTER XLVIII

THE CORPORATION

Definition

A corporation was defined by former Chief Justice Marshall in connection with the Dartmouth College case as "an artificial being, invisible, intangible, and existing only in contemplation of the law"—a definition which sets forth the fundamental characteristics of the corporation, viz., artificial personality and creation by the law. Blackstone says, "A corporation is an artificial person created for preserving in perpetual succession certain rights which being conferred on natural persons only would fail in the process of time." Blackstone's definition lays particular emphasis on a characteristic not specifically mentioned by Marshall, that of perpetuity of succession. It is apparent that the corporation within the limits prescribed by statute has most of the attributes and powers of a person —it can sue and be sued, can hold and pass title to property, real and personal, can carry on business in its own name, is responsible to the extent of its entire property for the payment of its debts, etc.

Growth of the Corporate Form of Organization

Within the last fifty years the corporate form has become very popular for the conduct of business of almost every kind. It offers a much more attractive field to investors, men who are desirous of placing their surplus funds in productive enterprises, in order to share in the profits of direct production without having the burdens of active management or the risk of losing their private for-

tunes to satisfy the claims of business creditors should the undertaking prove unsuccessful. Just as the partnership was an advance over the sole proprietorship in point of business organization, efficiency, and ability to cope with larger undertakings, so the corporation in some of its forms marks the most advanced stage of organization today. Its advantages and disadvantages in comparison with the partnership will be reviewed briefly.

Advantages

Some of its advantages are:

1. Limited liability. Only corporation property can be levied on to satisfy the claims of creditors; the private fortunes of the individual stockholders cannot be touched.

2. Continued existence. The death, withdrawal, or bankruptcy of any of its members does not interfere with its existence. Its life may be terminated by voluntary dissolution, insolvency, expiration of charter life, forfeiture of charter to the state for misuse, non-use, or abuse of its privileges.

3. Transferability of its shares, and their use as collateral for private loans without injury to the credit of the corporation.

4. Larger capital. A partnership becomes unwieldy and inefficient if the number of partners becomes too large. The number of stockholders in a corporation is not limited and varies from one to many thousands in the larger corporations. Accordingly much more extensive fields of endeavor are open to the corporation because it can bring together and use advantageously the combined capitals of many persons.

5. Centralized control. Its method of internal organization is such that one man can be made the responsible head instead of the many heads of the partnership.

Disadvantages

Its chief disadvantages may be summarized as:

1. Comparative absence of personal interest of the managing officer. This is largely a theoretical drawback. inasmuch as it is usually required that the managing officer be a stockholder.

2. As a creature of the state, the corporation is subject to its legislative control. It is taxable by the state and is required to make periodic reports

3. Its credit is dependent on the amount of its net assets and not on the fortunes of its individual owners.

4. Corporations are sometimes restricted as to the character of their business. In some states certain lines of business cannot be carried on by corporations.

5. In some states it is illegal for corporations to hold stock in other corporations.

In spite of these and other disadvantages, most of which are not serious, the corporation shows the best general results of any form of business organization.

The Formation of a Corporation

Formerly a corporation could be brought into existence only by a special act of the legislature. This proved a cumbersome method and one subject to much abuse, and it gave place in all states to general corporation statutes or enabling acts whereby application in due form and according to statutory provisions is all that is necessary. The statutes are different for each state but they are uniform in the main essentials. Formation under the New York statute will be explained.

Certificate of Incorporation—New York State

The form of application for a charter to do business as a corporation is known as a certificate of incorporation.

This must be prepared by at least three natural persons, two-thirds of whom must be citizens of the United States and at least one of whom must be a citizen of New York State. These are called the incorporators. Their certificate must be made out in the English language, signed by each incorporator, acknowledged before a notary public, and must contain:

1. The name of the corporation, in the English language. This must be different from the name of any other domestic or foreign corporation doing business in the state and must not contain in its title the words, "bank, trust, insurance, etc."

2. The purpose or purposes for which it is created. There is practically no limitation as to the lines of endeavor the corporation may declare itself desirous of following, with the exception that banks, trust, transportation, and insurance companies, etc., come under special laws.

3. The amount of capital stock of the corporation, common and preferred if both are to be issued. Preferred stock, of various classes, may be authorized after incorporation. The minimum amount of capital required by the New York law is $500. One-half of the capital must be paid in within one year from the date of incorporation. The certificate must state also the amount of capital to be paid in before the corporation can commence business and this must not be less than $500. No debts can be contracted before that amount is paid in.

4. The number of shares into which the authorized capital is divided and the par value of each. This must not be less than $5 nor more than $100, although more recently capital stock has been authorized with no named par value.

5. The place in which the principal office is to be located, which must be within the state.

6. The contemplated duration of its life. This may be made perpetual.

7. The number of directors, which must not be less than three.

8. The names and post-office addresses of the directors for the first year. Directors usually are stockholders and at least one-fourth of the directors are subject to election annually

9. The names and post-office addresses of the subscribers to the certificate of incorporation and the number of shares in the corporation subscribed by each.

Filing the Certificate—New York State

The certificate of incorporation is best made out in triplicate. The original must be filed and recorded in the office of the Secretary of State; the duplicate certified by the Secretary must be filed with the county clerk of the county where the principal business office is to be located; and the certified triplicate is retained by the corporation in its own files. The fees for filing the certificate with the Secretary of State are $10, and for recording 15 cents per folio. With the county clerk these fees are 6 cents per folio for filing.

Organization Tax—New York State

Previous to the filing of the certificate, there must have been paid to the State Treasurer an organization tax of one-twentieth of 1% of the authorized capital stock. Record of this payment is forwarded to the Secretary's office.

Initial Acts of Corporation

The corporation is now ready to commence business and its first act is usually a meeting of the incorporators and of the directors for the purpose of adopting a set of

by-laws—although this may be delegated to the board of directors. This meeting also authorizes the issue of stock at or above par in exchange for cash, labor, or property.

State Control

The outside control of the corporation is vested in the state. The state constitution, the general corporation law, the statutes relating to business organizations in general, and the specific contract between the corporation and state embodied in its charter or certificate of incorporation—these form the basis for state control and the limits within which the corporation may act as an authorized person. In case the corporation does an interstate business it is subject also to the regulations of the Interstate Commerce Commission.

Working Organization and Management

Within the corporation itself, its owners, the stockholders, are the source of all authority and control. Unlike the partnership where control and voice in the management are equally shared by the partners regardless of inequality in their investments, in the corporation ownership is evidenced by shares of stock and each share is given one vote. Thus each owner's authority and voting power are dependent upon the amount of his ownership of stock. Each owner has the right to delegate this power to another person by "power of attorney," and in this way it frequently happens that one stockholder exercises a power far beyond the amount of shares owned by him. Delegation of voting power frequently occurs when the stock is widely distributed geographically and its ownership is held in small lots. In that case, however, in theory the agent or attorney is simply carrying out the will of his principal, the real owner of the stock.

Annual Election of Directors

Because of the fact that the number of stockholders usually is large and many of them are engaged in other pursuits, it is one of the characteristics of the corporate form that the owners themselves cannot be engaged in the immediate management and control of the enterprise. Accordingly, at regular times, usually annually, the stockholders elect directors to whom are delegated the general oversight and control of the business. The board of directors thus elected stands in the place of the stockholders during the period between the annual meetings and at those meetings renders account of its management.

Officers

The board of directors elects officers of the company —usually a president, vice-president, treasurer, and secretary—and these may undertake the active management of the business, or the directors may appoint a general manager or superintendent on whom rests the active management and who is the executive head of the corporation. Thus the chief characteristic of the working organization of the corporation is delegated authority to a responsible head. The accountability of the officers to the board of directors, and the directors' accountability to the stockholders, have brought about the most efficient form under which modern business is conducted.

The Showing of Proprietorship

The chief difference, from an accounting viewpoint, between the corporate form and other forms of business organization is in the showing of proprietorship. Vested proprietorship in a sole-owner or partnership business is carried under the title of the different owners' capital accounts, and credit is extended by the public to such owners

not on the basis of what the particular business is worth, but on the reputation of the owners and what they are known to be worth outside the business as well as in the business. On the other hand, the law has relieved the owners of a corporation of individual liability for the debts of the corporation so that only the corporate property can be held liable for the satisfaction of creditors' claims.

However, for the protection of creditors a corporation is not allowed to impair its capital stock by the payment of any portion of it in dividends to the owners or to change the amount of its capital stock without special authority. The outstanding capital stock is, in theory, supposed to represent to the prospective creditor the least amount by which the assets can shrink and there still be left sufficient to meet in full the claims of creditors. Accordingly, the portion of the capital of a corporation represented by its capital stock is a fixed amount, and the increments or decrements of proprietorship are usually shown in a separate account called Surplus. This account must always be read with the Capital Stock account in order to know the real as distinguished from the original capital or proprietorship.

The Surplus account is sometimes divided and shown under such titles as Profits, Reserves, Undivided Profits, Working Capital, etc., but in order to know the full proprietorship or net worth all such accounts must be included.

Records Peculiar to a Corporation

The Subscription Book and Subscription Ledger

Upon the proper filing and acceptance of the certificate of incorporation, authority is given the incorporators to secure subscriptions to the capital stock. Subscription

books or blanks may then be opened, which usually contain a form of agreement somewhat as follows:

"We, the undersigned, do hereby subscribe for and agree to take the number of shares of the capital stock of the Blank Company, par value .... set opposite our names and pay for the same, ... per centum down, the remainder subject to the call of the board of directors."

Where the number of subscribers is large and especially if record must be made of the payment of calls, a Subscription Ledger or Instalment Book is used. This ledger has no set form but usually carries columns showing when the calls are to be made, when actually made, when paid, and the balance still due. A controlling account called Subscribers or Subscription is carried on the general ledger, with a special column in the cash book to gather the totals for posting.

The Stock Certificate Book and Stock Ledger

A subscriber is, as such, a stockholder in the corporation even though his stock certificate may not yet have been issued to him. The stock certificate is merely evidence of ownership. It is usually issued from a book with perforated leaves similar to a check book, with stub to carry the essential data of the certificate. Directly from this stub, or through the medium of a stock journal, postings are made to the individuals' accounts in the stock ledger. This is, in turn, controlled by the Capital Stock account or accounts on the general ledger. The stock ledger carries the detailed information as to the number of shares issued, shares cancelled, and balances held.

The Stock Transfer Book

In the State of New York a stock transfer book must be kept, showing all the data in connection with transfers

of shares, such as old and new stock certificate number, names of the parties, etc.

The Minute Book

To preserve a record of the meetings of the directors and stockholders, and the business transacted thereat, use is made of a minute book kept by the secretary. Its record should be complete, giving an accurate history of the management of the corporation from its organization through the entire period of its existence. This book, as the source of authority for all the important acts and policies of the corporation, is a most important record.

Other Records

When the stock is sold on the instalment plan, formal receipt of the payment of each instalment is sometimes made by means of an "Instalment Scrip Book," whose certificates or receipts are issued upon payment of each instalment. When full payment has been made, these instalment certificates are exchanged for the regular certificates of stock. A dividend book for recording the payment of dividends is sometimes kept though the need for such a record has been largely done away with through the use of dividend checks.

Practice Data*

(Assignment for Chapter XLVIII)

Make record in the various books of original entry of the following transactions for November, figures at left margin indicating day

*See Practice Data for Chapter XLVII.

of month. Where needed, directions appear at the close of each assignment.

1. Sold Colonial Supply Co., 1/5, n/30, $967.40 (A) and $205.10 (B) on which we prepaid freight and charged to them $30.65. Received cash on account from A. Mishkin, $1,000. Paid cash on account to The Stanley Works, $435.73.
2. Bought of American Hardware Supply Co., 3/5, n/20, $1,963.75 (A) and $2,189.62 (B). Sold Block Hardware Co., 2/10, n/60, $1,242.75 (A) and $963.29 (B). Received cash on account from Ted S. Class, $1,780.90. Paid cash on account to Central Machinery & Supply Co., $4,000.
3. Sold Ted S. Class, n/5, $2,120.75 (A). Received cash on account from Colonial Supply Co., $1,000.
4. Sold Griffen Mfg. Co., 3/10, n/30, $314.75 (A) and $175.20 (B). Received cash on account from M. Shapiro & Co., $2,008.73.
6. Bought of Mechanics Hardware Co., 5/10, n/30, $1,126.81 (A) and $1,093.42 (B). Sold Frank & Bros., 2/5, n/30, $1,250 (A) and $319.25 (B), with prepaid freight charged them $17.40. Received cash on account from Block Hardware Co., $2,000. Gave our note No. 17 at 6% for 30 days, favor of American Hardware Supply Co. to apply on account, $2,500.
7. Sold M. Shapiro & Co., 1/5, n/60, $2,500 (B). Our note No. 57, Ted S. Class, maker, came due and was paid with interest. Paid cash to American Hardware Supply Co., for invoice of November 2 less 3%.
8. Sold A. Mishkin, 1/10, n/30, $790.30 (A) and $410.75 (B). Block Hardware Co. returned goods, invoice of November 2, $15.32 (A) and $125.61 (B). Received from Colonial Supply Co. their note dated November 6, for 30 days, at 6%, in payment of invoice of November 1 less 1%.
9. Bought of Norton Door Check Co., 1/10, n/60, $2,819.18 (A) and $1,371.93 (B). Paid cash for insurance policy, $590.20.
10. Sold J. Kapner 1/10, n/60, $1,745.75 (A) and $730.19 (B). Received cash on account from L. M. Hoffman, $1,670.80.
11. Bought of The Stanley Works, n/60, $3,100.95 (A). Sold L. M. Hoffman, 2/5, n/90, $1,010.90 (A) and $593.70 (B). Griffen Mfg. Co. returned goods invoice of November 4, $69.81 (A) and $93.74 (B).
13. Sold B. F. Salzer 3/5, n/60, $527.55 (A) and $1,013.05 (B). Frank & Bros. returned goods, invoice of November 6, $72.17 (A) and $25.83 (B). Received cash from Frank & Bros. for balance of invoice of November 6 less 2%. Bought new equipment for the office, $375 cash.

14. Bought of Simmons Hardware Co., 3/10, n/30, $819.36 (A) and $3,181.64 (B). Sold Lowell & Meservy, 1/10, n/30, $1,190.10 (A) and $970.16 (B), with prepaid freight charged to them, $51.19. Received cash from Block Hardware Co. for balance of invoice of November 2 less 2%.
15. Sent a consignment of Department B goods, $1,500, to J. B. Grover to be sold for our account on a 5% commission basis. Drew a 30-day sight draft on Frank & Bros. to apply on account, $1,000, which he promised to accept. Received cash from Ted S. Class for invoice of November 3. Paid out-freight charges, $175.80.

Instructions

Be sure to enter the opening cash balance in both the General and Bank columns of the cash book.

Nov. 1. The "(A)" and "(B)" following sales and purchase transactions show the sales or purchases for Department A and Department B.

The prepaid freight which is to be charged to the Colonial Supply Co. on November 1 is to be entered in the Out-Freight column of the sales journal and included in the Total column amount to be charged them.

Nov. 4. The Griffen Mfg. Co. account is a mixed creditor and customer account, but is carried only in the purchase ledger. Make journal entry to adjust the controlling accounts as soon as sale of November 4 is entered in sales journal.

Nov. 8. The note transaction with the Colonial Supply Co. involves a sales discount. Enter the amount of the discount in the Sales Discount column of the note journal and extend the gross amount into the Sales Ledger column. Do not include the prepaid freight in the calculation of the sales discount.

Nov. 11. The Griffen Mfg. Co. returned sales of November 11 must be adjusted through the journal as in the November 4 transaction, but of opposite effect.

Nov. 15. Raise memo accounts through the journal for the J. B. Grover consignment as follows:

Consignment, J. B. Grover	$1,500.00	
Consignments-Out		$1,500.00

CHAPTER XLIX

OPENING AND CLOSING THE CORPORATION BOOKS

Corporation Accounting Records

The method of recording ordinary business transactions in a corporation is essentially the same as in the types of business organization previously discussed. The opening and closing of corporation accounts, however, as also the method of making the periodic summarization, call for special treatment, which is given in the present chapter.

Real Capital and Capital Stock

As stated before, the members of a stock corporation have their ownership evidenced by certificates of stock. The real capital or net worth of a corporation is the excess of its assets over its liabilities. This capital is shown in the books by two accounts, viz., the Capital Stock account which represents the amount of outstanding shares, and the Surplus account—subdivided and carried under other titles, if desirable—which represents the excess of the real capital over the amount of capital stock. Each stockholder's share in the corporation is determined by the number of shares he possesses.

Common and Preferred Stock

There may be various classes of stock. If only one kind is authorized at the beginning, the creation of other kinds would require an amendment of the charter. The usual classes of stock are common and preferred. As its name

indicates, preferred stock has some kind of preference over the common or ordinary stock. This preference may be only in regard to dividends, or it may include preference as to ownership in the net assets in case of dissolution. Preferred stock usually carries a fixed dividend payable before any dividend can be paid to the common stockholders.

Opening the Books of a Corporation—First Method

The opening entries of a corporation have to do with a correct treatment of capital stock, subscription, calls and instalments, payments by cash and by property, etc. A number of different methods of opening the books are employed, some of which will be illustrated by means of the following problems:

Problem 1. The Smith-Brown Company is incorporated with an authorized capital stock of $250,000, of which $150,000 is subscribed and paid for at par. The balance to remain unissued for the present.

Previous to the opening entries in the journal, there is usually made a formal statement of the organization of the corporation, its purposes, the capital stock issue, number of shares, the par value of each share, etc., somewhat according to the following illustration:

THE SMITH BROWN COMPANY

A corporation organized under the State of New York, with an authorized capital stock of Two Hundred and Fifty Thousand Dollars ($250,000) divided into Two Thousand, Five Hundred (2,500) shares of the par value of One Hundred Dollars ($100) each, with all powers necessary to carry on the business of manufacturing, selling, and distributing motors of all kinds.

After this statement of organization the opening entries are set up on the books, as follows:

(a)	Unissued Capital Stock..................	$250,000.00	
	Capital Stock......................		$250,000.00
	To bring the authorized issue on the books.		
(b)	Subscriptions	150,000.00	
	Unissued Capital Stock............		150,000.00
	To record subscriptions to the capital stock as follows: A.... ....shares B.... .... " C.... .... " Etc.		
(c)	Cash	150,000.00	
	Subscriptions		150,000.00
	To credit subscribers for the payment of their subscriptions.		

Entry (a) shows the authorized capital stock and sets up in its contra debit to Unissued Stock, a contingent asset through the sale of which the company expects to be able to secure the cash required for organizing and carrying on the business.

Entry (b) records the subscription contracts for the purchase of part of the unissued stock by certain subscribers. Where the subscriptions are numerous, no detail is shown in this entry, such being carried in the subscription book whose total is then the basis for this entry in the journal. Subscriptions, or Subscribers as the account is sometimes called, is thus a summary or controlling account for the subscription ledger if this is used.

The debit balance of the Unissued Capital Stock, then, is $100,000, and this together with the Capital Stock credit of $250,000 shows a balance of $150,000 as outstanding capital stock. On the balance sheet the unissued stock should not be shown as an asset but as a subtraction from the capital stock credit.

Entry (c) simply extends credit to subscribers when they

make payment. This entry is, of course, made in the cash book.

Opening the Books of a Corporation—Second Method

An alternative method of recording the above data uses separate accounts for Subscribers and Subscriptions. This may be done when subscribers do not pay for their shares immediately upon subscription. In this case the Subscriptions account represents the obligation on the part of the corporation to issue certificates of stock to the subscribers, and the credit to Subscriptions is therefore cancelled when the stock is actually issued, as shown in entry (d) below.

(a)	Unissued Capital Stock..................	$250,000.00	
	Capital Stock......................		$250,000.00
(b)	Subscribers	150,000.00	
	Subscriptions		150,000.00
(c)	Cash	150,000.00	
	Subscribers		150,000.00
(d)	Subscriptions	150,000.00	
	Unissued Capital Stock...........		150,000.00
	To record the issue of stock to all subscribers who have paid in full.		

From a theoretical point of view this method is undoubtedly better than the first, particularly where subscriptions are paid in instalments. However, where payment is made almost at the same time as the subscription, it seems unnecessary to have a separate account for subscribers.

Opening the Books of a Corporation—Third Method

A third method is as follows:

(a)	Unsubscribed Stock	$250,000.00	
	Capital Stock Authorized..........		$250,000.00
(b)	Subscriptions (or Subscribers)............	150,000.00	
	Unsubscribed Stock..............		150,000.00

(c) Cash	150,000.00	
Subscriptions (or Subscribers).....		150,000.00
(d) Capital Stock Authorized................	150,000.00	
Capital Stock		150,000.00

This method is practically the same as the second shown; the account titles given here are not so commonly met with.

Opening the Books of a Corporation—Fourth Method

A fourth method, and one which is perhaps commended by a majority of accountants, makes a distinct separation between memorandum entries and so-called financial transactions. Until the stock has either been paid or subscribed for, no formal entry, other than the statement of organization referred to above, is made on the books of account. Of course, full record of all deliberations and resolutions as to procedure and policy up to the time of the actual sale of stock is carried in the minute book. Using the data of the previous illustration, entries would be:

1. Where the subscription and payment are not simultaneous transactions:

(a) Subscribers	$150,000.00	
Capital Stock Subscriptions........		$150,000.00
(b) Cash	150,000.00	
Subscribers		150,000.00
(c) Capital Stock Subscriptions................	150,000.00	
Capital Stock		150,000.00

2. Where the subscription and payment are simultaneous transactions:

(a) Cash	$150.000.00	
Capital Stock		$150,000.00

It may be said in support of this method that it reflects an effort being made to combat a too prevalent tendency to make memorandum entry on the books of account of all

sorts of things, many of which can have sufficient and full record in the minutes or in other memorandum records. Furthermore, the method is simple and gives a full statement of all financial facts. On the balance sheet, however, the unissued stock would be shown just as under the other methods.

Premium or Discount on Stock

Where stock is sold at a premium or at a discount, true record should be made of the facts as they are. In the State of New York a corporation cannot sell its stock at a discount, but where this is allowed losses so incurred should be charged to a "Discount on Stocks" or similar account. More often the charge is to an account called "Organization Expense." Full discussion of this matter is taken up later. The following illustration is simply given to show the kind of entries required.

Problem 2. Of the $100,000 unissued stock of Problem 1 we will assume that $50,000 is later subscribed for at 98 and $50,000 at 102. Entries to make the record according to method (4), Problem 1, are as follows:

(a) Covering stock subscribed for at a discount:

Subscribers	$49,000.00	
Discount on Stock	1,000.00	
Capital Stock Subscriptions		$50,000.00

(b) For stock subscribed for at 102:

Subscribers	$51,000.00	
Premium on Stock		$1,000.00
Capital Stock Subscriptions		50,000.00

Payment of the subscription would follow the method of entry shown above. It will be noted that the Capital Stock account always shows at par value.

Instalments

If payment is made by instalments in response to regularly issued calls, the asset formerly carried under the title Subscribers or Subscriptions is transferred to Call or Instalment accounts as illustrated in the next problem.

Problem 3. The $50,000 of stock subscribed for at 102 above, it is assumed, was to be paid for one-half in cash and the remainder in two equal instalments at the end of successive three-month periods. The entries would be as follows:

Cash	$25,500.00	
Subscribers		$25,500.00

for the one-half cash payment.

At the end of the first three months, record would be:

Call No. 1..	$12,750.00	
Subscribers		$12,750.00
To show the call issued.		
Cash	12,750.00	
Call No. 1............................		12,750.00
To record payment of the first call.		

Similar entries at the end of the second three months would be:

Call No. 2..	$12,750.00	
Subscribers		$12,750.00
Cash	12,750.00	
Call No. 2............................		12,750.00

If the call is not paid in full at balance sheet time, the debit balance in the "Call" accounts would constitute an asset, i.e., the amount of unpaid instalments due from subscribers.

Entries for Common and Preferred Stock

Where more than one kind of stock is issued, such as common and one or more kinds of preferred, separate capital

stock accounts should be kept for each class, as illustrated below.

Problem 4. Be it assumed that the stock of Problem 1 is $200,000 common and $50,000 preferred, and that $100,000 common and $50,000 preferred have been subscribed for. The entry corresponding to (a) under the fourth method would be:

Subscribers—Capital Stock Common..........	$100,000.00	
Capital Stock Common, Subscriptions...		$100,000.00
Subscribers—Capital Stock Preferred.........	50,000.00	
Capital Stock Preferred, Subscriptions...		50,000.00

The other entries would be essentially the same as explained above but the transactions affecting common stock and preferred stock must be kept separate.

Payment of Subscriptions by Property

When payment of subscriptions is by property instead of by cash, the value at which such property shall be brought onto the books is entirely at the discretion of the corporation's directors, and, unless fraud can be shown, their valuations are final. No difficulties are involved in recording such a payment; the paid properties are debited, under suitable account titles, and the Subscribers account (or Subscriptions) is credited. The following problem illustrates the change from a partnership to a corporation, at the same time showing how the payment of subscriptions by property must be treated.

Change from Partnership to Corporation

Problem 5. A and B, partners, incorporate as the American Baking Company, issuing to each partner stock at par for his interest in the partnership, and selling C the remainder of the capital stock at par for cash. The authorized capitalization is $250,000. The corporation purchases the

assets and assumes the liabilities of the partnership, paying therefor with stock as above. The balance sheet of the partnership on that date showed as follows:

BALANCE SHEET OF A & B

Cash	$20,000.00	Accounts Payable	$45,000.00
Accounts Receivable	150,000.00	Mortgage Payable	80,000.00
Merchandise	50,000.00	A, Capital	125,000.00
Plant	130,000.00	B, Capital	100,000.00
	$350,000.00		$350,000.00

Make the opening entries for the new corporation and also close the books of the partnership.

1. The entries to open the corporation's books:

(a)	Cash	$20,000.00	
	Accounts Receivable	150,000.00	
	Merchandise	50,000.00	
	Plant	130,000.00	
	A & B, Vendors		$350,000.00
	To record the purchase from A & B of their partnership assets.		
(b)	A & B, Vendors	125,000.00	
	Accounts Payable		45,000.00
	Mortgage Payable		80,000.00
	To record partial payment to A & B for their assets by the assumption of their partnership liabilities.		
(c)	A & B, Vendors	225,000.00	
	Capital Stock		225,000.00
	To record full payment to A & B for the balance due them, by cancellation of their subscription indebtedness and the issuance to them of stock for their respective interests in the former partnership.		
(d)	Cash	25,000.00	
	Capital Stock		25,000.00
	C pays his subscription.		

350,000
225,000
125,000

Entries (a), (b), and (c) are sometimes combined in the following compound entry:

Cash	$20,000.00	
Accounts Receivable	150,000.00	
Merchandise	50,000.00	
Plant	130,000.00	
Accounts Payable		$45,000.00
Mortgage Payable		80,000.00
Capital Stock		225,000.00

Although this accomplishes the same result and ultimate showing, it does not present the various steps of the transactions so clearly as the separate entries. The "A & B, Vendors" account in entry (a) is a liability account, indicating the purchase from A and B of their partnership properties. Entries (b) and (c) show the manner in which A and B are paid for this purchase with consequent cancellation of that liability.

2. The entries to close the books of the partnership of A & B:

(a)	American Baking Company	$350,000.00	
	Cash		$20,000.00
	Accounts Receivable		150,000.00
	Merchandise		50,000.00
	Plant		130,000.00
	To charge the American Baking Company with the assets purchased under contract of ...... (date).		
(b)	Accounts Payable	45,000.00	
	Mortgage Payable	80,000.00	
	American Baking Company Stock	225,000.00	
	American Baking Company		350,000.00
	To credit the American Baking Company on their purchase contract for the taking over of the firm's liabilities and the payment of the balance due by the issue of their stock at par to the firm.		

(c)	A, Capital...............................	125,000.00	
	B, Capital..............................	100,000.00	
	American Baking Company Stock..		225,000.00
	To show the distribution of the stock to the partners in settlement of their interests in the firm.		

Where the stock is issued to each partner directly (instead of to the firm and then distributed to the vendors), sometimes the stock is not shown on the partnership books, entry (b) above carrying debits to the partners' capital accounts in place of the debit to American Baking Company Stock. Whether the actual transaction followed one course or the other, entries as shown above would seem to meet either requirement.

The student should make sure that the effect of the entries under (a) and (b) is thoroughly understood. It may be further noted that if good-will or shrinkage of values enters into the sale of partnership, the necessary adjustments should be made in the partners' accounts before the sale takes place, after which the closing entries will be as above.

Current Record on Corporation Books

After the books of the corporation are opened, current record on them of regular transactions proceeds just as for a partnership. However, there are no charges or credits to the owners of the corporation resembling those to the partners' personal accounts. All personal accounts on the corporation's books are on the same basis, i.e., all persons including the officers, directors, and stockholders are treated as "outside" parties.

Dividends

At the close of the fiscal period the results are summarized by means of the Profit and Loss account, and the

distribution of the net profits is made in the appropriation section. Usually the net profit is divided among the shareholders, the amount of profit for each share being called the dividend. However, it is within the power of the board of directors to withhold dividends.

Sometimes it is advisable to retain part of the profits in the business to provide for expansion or to meet current demands of the business, and the board of directors decide whether all, only a portion, or none of the profits shall be paid out.

Ultimate Control of Stockholders

Although the board of directors exercises great power during the time for which it was elected, it is ultimately subject to the will of the stockholders, in that at the annual meetings the majority may elect a new board. The new board will presumably carry out the will of the majority stockholders.

Dividends Out of Profits Only

It is forbidden by law to pay dividends out of the capital of the corporation. Such payments would encroach upon the net assets of the organization and thereby weaken the security possessed by creditors for the payment of their claims. Dividends need not be paid out of the profits of the current year, provided there are profits not fully distributed during former periods and available now.

Distribution of Profits

The usual entries required for closing the books of a corporation differ from those of the partnership mainly in handling the distribution of net profits. These entries are not necessarily the same for all corporations nor for all periods. No set disposition of profits is prescribed, authority

for the disposition resting with the directors. Their decision, therefore, as recorded in the minutes of their meetings, is the basis for this group of entries. Some of the usual entries are illustrated in the following paragraphs.

At the start it should be stated that two methods prevail for the booking of a declared dividend. Under one method the charge is to the current Profit and Loss account with a credit to Dividends account; under the other, the total net profit is transferred to Surplus, which then shows not only the profit for the current year but also the undistributed profit balance of previous years, and the current dividend is declared out of this total Surplus.

Reserves

A part of the profits may be retained in the business to provide funds for certain future needs as for the payment of fixed debts, the extension of fixed plant, etc. Such items should be taken out of the Surplus account and transferred to the credit of properly named reserve accounts so that the Surplus balance will always indicate accrued profits available for dividend purposes.

Problem 6. The net profits of Jackson & Co. are $25,000. The directors declare an 8% dividend on the outstanding capital stock of $100,000, and order $5,000 transferred to a reserve for buildings and $7,000 to a reserve for the cancellation of a bond issue. The following entries should be made where it is desired to show the disposition on the face of the Profit and Loss account.

Profit and Loss................................	$20,000.00	
Dividends		$8,000.00
Building Fund Reserve....................		5,000.00
Sinking Fund Reserve....................		7,000.00
To appropriate profits as per resolution of the directors.		

Profit and Loss................................	5,000.00	
Surplus		5,000.00
To transfer balance to the Surplus account.		

On the other hand, where appropriation is made out of Surplus:

Profit and Loss................................	$25,000.00	
Surplus		$25,000.00
To transfer net profits to Surplus.		
Surplus	20,000.00	
Dividends		8,000.00
Building Fund Reserve....................		5,000.00
Sinking Fund Reserve....................		7,000.00

Dividend Liability

Upon the declaration of a dividend, the liability so created ranks with the other liabilities, i.e., the assets of the corporation are applicable to a dividend liability to its stockholders equally with the liabilities to outside creditors. The payment of such dividend is booked by the cancellation of the dividend liability, as follows:

Dividends	$8,000.00	
Cash		$8,000.00

Where there is more than one class of stock outstanding, it is customary to keep separate dividend accounts with each class. The rate of dividend is always based on the amount of outstanding stock as on the date the dividend is declared.

Problems

(Assignment for Chapter XLIX)

1. A corporation is formed with a capital stock of $100,000, entirely subscribed for and with two-fifths paid in cash. Show journal entries covering.

2. The remaining three-fifths of the capital in Problem 1 is subject to call at the end of each succeeding month. The first call has been made and one-half paid in. Show journal entries covering.

3. Lehman and Underwood, partners in a trading business, decide to incorporate. The authorized capital stock is to be $50,000; shares $50 par value. They interest J. Q. Quinn and I. M. Bean in the new company, receiving subscriptions, paid in cash, for 100 and 300 shares respectively. Lehman and Underwood subscribe for the remaining stock in the ratio of their interests in the old business, which at that date shows as follows:

Assets		*Liabilities and Capital*	
Cash	$ 4,500.00	Accounts Payable	$ 5,269.30
Stock	8,250.00	Mortgage Payable	4,500.00
Accounts Receivable	10,690.30	Notes Payable	1,500.00
Notes Receivable	1,250.00	Rent Accrued	125.00
Land	6,000.00	Interest Accrued	26.00
Buildings	5,000.00	Lehman, Capital	17,470.00
Furniture & Fixtures	1,000.00	Underwood, Capital	8,735.00
Delivery Equipment	875.00		
Insurance Prepaid	50.00		
Interest Accrued	10.00		
	$37,625.30		$37,625.30

They pay their subscriptions by turning over to the corporation their old business at the values stated above except the cash which is retained by them personally. Open a new set of books for the corporation. Close the partnership books and show distribution of assets.

4. The Jackson Co. has outstanding capital stock of $75,000. This year's Profit and Loss shows a profit of $2,120.69. The previous Surplus balance is $12,182.40. They declare and pay a 6% dividend. Show, in journal form, the entries covering the above.

CHAPTER L

CONSIGNMENTS

Definition

When a merchant ships goods to another party to be sold by him for account of the shipper, the transaction is called a "consignment." In its original sense, "consign" means to seal, sign, mark, or label in a formal way. In commerce, this term has come to apply to goods sent for sale as explained above, and usually such goods are marked or labelled to distinguish them from those belonging to the consignee. The owner or sender is designated as the consignor, the selling or receiving party as the consignee. Sometimes the word "shipment" is used to designate the goods sent away for sale by the consignor, and the word "consignment" to indicate the goods from the viewpoint of the consignee. Differentiation on this basis is worth while, but the terms "consignments-out" and "consignments-in" are more descriptive and these titles will be used here.

Legal Status

Before treating of the accounts required to record this class of transactions, it is well to understand the legal relations between the consignor and consignee. The general law of bailments and of agency applies in a restricted sense to consignments. A bailment has been defined as, "A delivery of goods for the execution of a special object, beneficial to the bailor, the bailee or both, upon a contract expressed or implied, to carry out this object, and dispose of the property in conformity with the purpose of the trust." Agency is the term used to indicate the legal relation be-

tween a principal and his agent, the latter representing the former. A person appointing another to act for him in his dealings with third parties is called the principal. The one appointed to represent the principal is the agent. A bailment is, therefore, a special class of agency transactions with particular rules governing the safe-keeping of the goods of the principal in the possession of the agent. In the case of a consignment, the consignor is the principal and the consignee the agent. The relation of the consignee to the consignor as regards the care to be exercised in handling the consignor's goods is a bailment relationship.

The Broker

A broker, although he acts as agent, usually is not a consignee. He acts "as a middleman, bringing people together to trade, or trading for them in the private purchase or sale of any kind of property, which property, ordinarily, is not in his possession." The charge for his service is usually in the form of a commission, sometimes called brokerage. Several classes of brokers are met with, named according to the kind of commodity dealt in; for instance, the exchange broker, note broker, insurance broker, stock broker, real estate broker, merchandise broker, etc.

The Factor

Another similar type of middleman is the manufacturer's agent, who is a broker or sales agent, effecting sales usually by means of samples; and the factor or commission merchant who actually handles and sells the goods of his principal. The chief distinction between the broker and the factor is that the broker sells goods in the name, and for the account, of his principal, but the goods are delivered directly by the principal who also collects the account; while the factor has the goods of his principal in his possession

and sells them either in his own name or in the name of his principal.

The factor may operate under a specific contract with his principal, covering a single consignment, or it may happen that a general contract governs all consignment transactions between the two parties. Again, there may not be any formal contract between them and in this case the law sets up a contract relationship based on trade usage and customs in any particular line. Where the factor operates under a specific or general contract, certain points may arise which are not provided for in such contract, and then trade custom governs.

Duties of the Factor

Barring specific instructions, the factor may conduct the consignment transactions for his principal on the same basis and in the same general way as he would conduct them were the goods his own. In other words, he is expected to exercise the same care in the handling of consignment goods as he employs in handling his own property. In selling goods consigned to him he may extend credit to the buyer if it is the custom in that particular line to do so, and he must exercise due care as to the rating of the customer. His collection must be pushed with ordinary diligence. He may warrant the goods sold if that is customary. He can give good title to goods sold, and this title may even be better than the one possessed by the owner of the goods. A bona fide purchaser who does not know the principal is protected in a sale made by a factor even if the factor exceeded his authority.

Factor Must Protect Goods

So long as the principal's goods or any part of them are unsold and in the possession of the factor, he must pro-

tect and safeguard them. He is not liable, however, for damage from forces or conditions over which he has no control. The degree of diligence required of him largely depends on the nature of the goods. What would be considered due diligence in one case might be construed as gross neglect in the case of more valuable or perishable goods.

Consignments to Be Kept Separate

It is a fundamental requirement and of the very essence of the factor relationship, that the principal's goods must be kept distinct from all other goods in the factor's possession. This applies not only to the consigned goods as such but also to the assets received by the factor upon the sale of such goods—as cash, accounts and notes receivable, etc. To satisfy this latter requirement it is usually held that actual separation is not necessary, but that it is sufficient to record these properties in such a manner that they can always be separated if the need arises. The principal's properties are held in trust for him by the factor but are subject to the legitimate claims of the factor.

Expenses Charged Against Consignment

Barring specific instructions to the contrary, the factor may incur certain expenses necessary to safeguard the interest of his principal and to effect the sale of his goods. These include such items as freight, insurance, duty, handling charges, allowances and rebates to customers for unsatisfactory goods, etc. All of these are proper charges against the consignment, i.e., against the principal.

Factor's Lien on Consigned Goods

For any legitimate expenses incurred and for any payments made the principal in advance of a settlement date,

the factor has a lien on the consigned goods. It has been held in some cases that the factor has the right to sell the goods in satisfaction of the lien, and, in case the proceeds of the sale are not sufficient to satisfy the factor's claims against the principal, the latter is liable in the amount of the deficiency. The factor's commission due him by the principal is also protected by this lien and, if necessary, the factor may apply part or all of the proceeds of the sale towards the payment of his commission. A lien, of course, is binding only so long as the goods are in the factor's possession.

Account Sales

Upon completion of the service rendered by the factor, he must make a strict accounting of his transactions to the principal. Full justice would require that he open all his records covering the consignment dealings to the inspection of the principal if this latter so desires. The usual method of settlement is by means of an "account sales" rendered by the factor to his principal. The account sales is a summarized statement of all transactions connected with a particular consignment. It must show the amount or quantity of goods received, the sales made, and the expenses incurred, the balance being the amount due the principal. This may be either remitted or credited to the principal's account, according to the contract between them. A usual form of account sales as rendered by the factor to his principal is shown on page 470. This closes the account for the particular shipment.

Sometimes the price on goods received is not shown; where shown, it serves as a guide to the factor as to the sale price desired. It does not enter into the factor's transactions or accounting.

ACCOUNT SALES
of fruit received via Seaboard Air Line, from
H. C. CLONEY, BRADENTOWN, FLA.,
to be sold for his account and risk

RENDERED BY GAYNOR & GAYNOR, 21 WHITEHALL ST.,
NEW YORK, MARCH 3, 1917

1917								
Feb.	2	Received:						
		250 bxs.	oranges	@	$3.75	937.50	
		100 "	lemons	@	4.25	425.00	1,362.50
			Sales				
Feb.	3	100 bxs.	oranges	@	$4.50	450.00	
		75 "	lemons	@	4.40	330.00	
	5	150 "	oranges	@	4.75	712.50	
		25 "	lemons	@	5.00	125.00	1,617.50
			Charges				
		Freight & Cartage				50.00	
		Commission 5%				80.88	130.88
		Net proceeds by check enclosed					1,486.62

E. & O. E.

Compensation of Factor

The factor may receive his compensation on a commission basis—so many per cent of the sales he makes. When the contract so provides, the factor may sell the goods at a higher price than that fixed by the principal and retain part or all of the excess.

"Del Credere" Agency

Where a factor sells on credit, the accounts belong to the principal and any loss through uncollectible accounts is borne by the latter. Sometimes the factor guarantees the collection of all accounts; in this case he is known as a

"del credere" agent and receives additional compensation for assuming this risk. Such a guarantee really amounts to a sale of the accounts to the factor.

Advantages of Consignments

While the practice of consignment trading is not so prevalent now as it was formerly, it still prevails in some lines and under certain conditions. Shippers to the produce market frequently consign their goods to city brokers whom they instruct to take advantage of the prices prevailing in the open market, and in this way they may realize higher prices than when they sell outright to the wholesaler. The consignment shipment has another advantage to the shipper in that the title to the goods remains vested in him; hence a consignment is safer than a sale on credit to a consignee unless his rating is satisfactory. The practice of consignment trading is of sufficient importance to require a discussion of the accounting principles involved. These will be given first from the viewpoint of the consignor, and then from that of the consignee.

The Consignor's Entries

The chief interest of the consignor lies in the net outcome of each sale in order to determine the advantage, if any, of the consignment policy over a straight sale policy. To accomplish this, he must keep a separate account with each consignment. This may be done on the general ledger or on a subsidiary ledger with a total or summary account on the general ledger. When the consignor sends the goods, whether they be invoiced at cost, sale, or some other price, entry should not be made direct to his Sales account, for no sale has been made as yet. He has merely placed some of his stock in another market, but he is still the owner of the goods.

Two Methods of Entering Sales on Consignor's Books

There are two ways of recording correctly a consignment on the consignor's books at the time the goods are sent. According to one method, the goods are transferred from Purchases to another merchandise account called Consignment; this title usually being followed by the name of the consignee and the number of the particular consignment to him, as "Consignment No. 4, J. B. Arscott." To this consignment account are charged not only the goods at cost price but also all expenses of the transfer, as freight, duty, insurance, etc.; the corresponding credits being to Cash or to Purchases as the case may require. This is the only record made, until the receipt of the account sales from the factor.

Upon its receipt, the Consignment account may be credited with the net proceeds as shown in the account sales, and if the money is remitted by the factor, the cash account is debited; otherwise the amount is charged to the factor's personal account. Instead of this the Consignment account may be charged with the expenses and credited with the gross sales shown by the account sales, whereas cash or the factor's account is debited for the net proceeds as above.

In either case, the Consignment account is now a true proprietorship account, showing income on the one side and cost of that income on the other side. The difference is either a profit or a loss according as the balance is a credit or a debit. In order readily to distinguish completed consignment transactions from those only partially completed, it is best to close the completed accounts by a transfer of the balance to a "Consignments Profit and Loss" account where it is held until the close of a fiscal period, at which time it is carried to the general profit and loss.

The second method of recording the transaction at the

time of sending the consignment is to set up two memorandum accounts, Consignment and Consignment-Out (or Consignment Sales), debiting and crediting these respectively with the invoiced value of the consigned goods. In this case there is no credit to the Purchases account as under the first method given above. Any expenses incurred are charged to the regular expense accounts instead of to the Consignment account. For handling the consignment shipments, no special books are required, original entry being in the general journal. If there are many such transactions, however, a special column in the sales journal or a special consignments-out journal would result in a considerable saving of labor.

Upon receipt of the account sales, the regular sales account is credited either with the net or with the gross proceeds; and the other accounts—as cash, the consignee, and expenses—are debited according to the manner of booking as explained above in connection with the first method.

The two memorandum accounts having served their purpose of calling attention to the fact that some goods were sent to other markets for sale, should now be cancelled by a reversing entry, since those goods have now been sold and the record of their sale has been made in the regular sales account. The effect of this second method is to merge consignment and regular sales transactions into one record, making impossible a separate showing of the profit or loss on consignments. The method of handling, therefore, will depend upon the information desired.

Consignor's Inventory

If the consignor's fiscal period closes before an account sales in full settlement is received, and if treatment is by the first method given above, the goods shown in the Consignment account are included in the inventory of goods

on hand and so shown in the balance sheet. If the second method is used, the Consignment and Consignment-Out accounts are both omitted from the balance sheet, being merely cancelling memorandum entries, and the consigned goods which actually are in the hands of the consignee, unsold, are included in the inventory. In determining the value of consigned goods, the expenses incurred in sending the goods to the new market may properly be included as a part of the cost.

The Consignee's Entries—First Method

Two methods of making the entries on the consignee's books at the time of receipt of the goods are met with. In the first method, two memorandum accounts, Consignments and Consignments-In, are set up, Consignments being debited for the billed value of the goods received, and Consignments-In being credited for the same item. The purpose of these accounts is merely to set up on the general books a reminder of the transaction. A third account, John Doe, Principal, is used for current record. This account is charged with all expenses incurred in connection with this consignment and is credited with all sales made therefrom. It is charged also with the consignee's commission. The balance of the account is, at completion of the sale, the amount due the consignor, Doe. When this is paid, the account is closed by a debit to John Doe, Principal, and a credit to cash or notes payable. So long as the balance is unpaid, the account, John Doe, Principal, shows the factor's liability to his principal. This is a special kind of liability, that of a trustee, which is indicated by the inclusion of the word "Principal" in the account title; in case of insolvency a portion of the assets equal to the balance of John Doe, Principal's account belongs to John Doe and must be so treated. When the sale has been completed, the memoran-

dum accounts, Consignments and Consignments-In, are cancelled against each other, having served their purpose.

The Consignee's Entries—Second Method

The second method makes no entry on the general books of the receipt of the goods. Entry is made in a blotter or memorandum book of consignments received, stating all essential data, covering the name of consignor, quantity, price, legend or distinguishing marks, etc. Expenses incurred are charged to John Doe, Consignment account on the general books, and sales are credited to the same account. Settlement is made as with John Doe, Principal, as explained above, except that when the balance is not paid it frequently is transferred to a simple John Doe personal account, where so far as account title is concerned it loses its character as a trust account and is merged with all other creditors. The first method would seem to give the better treatment, although the use of memorandum accounts is generally discouraged.

Consignments Must Have Distinguishing Marks

In making his record of sales from the various consignments, the factor must be careful to record them in such a way that the consignments from which the goods were taken may be easily distinguished. This is particularly true of sales on account, for if the accounts prove uncollectible it is important to know to which lot the loss must be charged. This is accomplished by recording the consignment legend or mark with the sale.

Factor's Books at Close of Fiscal Period

At closing time for the factor, all commissions earned on consignment sales made to date, whether the entire consignment transaction is fully or only partially completed,

should be taken into account. In the case of completed transactions these commissions should already be on the books as debits to the various principals' accounts and credits to "Commissions Earned." In the case of incomplete transactions, it will be necessary to bring them on the books by entry of the accrued income in the "Commissions Earned" account, the amount being based on the sales made during the period. The accounts with these incomplete transactions may show either debit or credit balances. If a debit balance is shown, the account is an asset representing the consignee's claim against his principal for expenses incurred in excess of sales made. If a credit balance is shown, the account represents a trust liability as above. At a closing time the memorandum accounts of incomplete transactions should be adjusted to their present inventory values.

Consignee's Inventory

Just as the consignor must be careful to include in his inventory all goods of his out on consignment, so the consignee must be equally careful to exclude from his inventory all goods of his principal's still unsold and in his possession.

Illustrative Entries on Consignor's and Consignee's Books

An illustration of a simple consignment transaction from the viewpoint of both consignor and consignee is here given. Suppose a consignment transaction to have taken place as follows between J. J. Querles and I. M. Factor:

Querles sends to Factor to be sold on his account goods at cost amounting to $1,250, paying cartage $15, and insurance $25. Factor pays freight, duty, and cartage, $52.50. He makes sales of $1,600, rendering an account sales showing also allowances to customers of $27.30, a 5% commission charge and 1% for guaranteeing collection of all accounts, and the net proceeds credited.

1. Querles' books at time of sending goods to Factor:

(a)	Consignment, I. M. Factor, No. 1	$1,250.00	
	Purchases		$1,250.00
(b)	Consignment, I. M. Factor, No. 1	40.00	
	Cash		40.00
	Cartage $15, insurance $25.		

2. Factor's books at time of receipt of Querles' goods:

(a)	Consignment	$1,250.00	
	Consignments-In		$1,250.00
	To set up memo accounts of the receipt of Querles' goods.		
(b)	J. J. Querles, Principal	52.50	
	Cash		52.50
	Freight, duty, and cartage on Querles' goods.		

3. Factor's books during course of consignment transactions:

(a)	Customers	$1,600.00	
	J. J. Querles, Principal		$1,600.00
	To credit Querles with the sales.		
(b)	J. J. Querles, Principal	123.30	
	Customers		27.30
	Commissions		80.00
	Collections Guarantee		16.00
	To charge Querles with all expenses.		
(c)	Consignments-In	1,250.00	
	Consignment		1,250.00
	To reverse.		

4. Querles' books upon receipt of account sales:

(a)	Consignment, I. M. Factor, No. 1	$175.80	
	I. M. Factor	1,424.20	
	Consignment, I. M. Factor, No. 1		$1,600.00
	To credit the consignment with its sales and charge it with its expenses, including commission, and to charge Factor with the balance due.		

(b) Consignment, I. M. Factor, No. 1............	134.20	
Consignments Profit and Loss.........		134.20
To transfer the profit on this consignment.		

5. When Factor finally remits the balance $1,424.20, his entry would be:

J. J. Querles, Principal..........................	$1,424.20	
Cash		$1,424.20

thus cancelling his liability to Querles; and Querles' books would show:

Cash	$1,424.20	
I. M. Factor...............................		$1,424.20

cancelling his claim against Factor.

If the second method (as explained on page 472) of making the consignor's record is used, the entries under No. 1 would show as follows:

(a) Consignment, I. M. Factor, No. 1............	$1,250.00	
Consignments-Out		$1,250.00
(b) Cartage	15.00	
Insurance	25.00	
Cash		40.00

and No. 4 would show:

Freight	$52.50	
Sales Allowances................................	27.30	
Commissions	96.00	
I. M. Factor......................................	1,424.20	
Sales		$1,600.00
Consignments-Out	1,250.00	
Consignment, I. M. Factor, No. 1...........		1,250.00
To reverse.		

In these last entries consignment sales are included in the regular sales account, and its profit or loss is merged with that from regular sales. As to which method to use, decision must be made according to the information desired

by the principal. Where consignment transactions are not the main line of sales endeavor, the record would usually be kept by the first method because this brings out the profit or the loss on each such transaction. This is sometimes called the occasional consignment theory or method.

Where the consignment transaction is the usual method of securing a market and so of effecting sales, the records as kept under the second method illustrated above are usually to be advised, because under this method all consignment transactions are properly included in the regular sales and expense records.

Practice Data*

(Assignment for Chapter L)

November 16. Bought of the Dixie Lumber Co., n/90, lumber and supplies for the building of sky lights on our warehouses, $723.18, with prepaid freight of $59.20 charged to us. We returned to Norton Door Check Co., invoice of November 9, $421.16 (A) and $83.24 (B). Sold Builders Supply Co., n/60, $1,920.18 (A) and $1,000 (B). Gave our note No. 18 at 6% for 30 days, favor of Mechanics Hardware Co., for invoice of November 6 less 5%. Received cash from M. Shapiro & Co. for invoice of November 7 less 1%.

17. Sold Colonial Supply Co., 1/5, n/30, $579.63 (A) and $814.12 (B), with prepaid freight charged to them $32.16. Note No. 65, Builders Supply Co. maker, came due and was paid with interest. Paid in-freight and cartage bills to date, $364.20.

18. Bought of Central Machinery & Supply Co., 2/5, n/60, $1,283.17 (A) and $2,719.72 (B). Sold Ted S. Class, n/5, $879.63 (A) and $479.81 (B). B. F. Salzer returned goods, invoice of November 13, $110.35 (A) and $38.25 (B). Drew from stock for building sky lights, goods, $200 (A) and $57.80 (B). Paid Norton Door Check Co. balance of invoice of November 9 less 1%.

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*See Practice Data for Chapters XLVII and XLVIII. Figures at left margin indicate day of month.

20. We returned to Simmons Hardware Co., invoice of November 14, $89.33 (A) and $187.55 (B). We received notice from the receiver of one of our Sundry Customers, who owed us $219.57, that no dividends would be paid. We accepted The Stanley Works draft, to apply on account, drawn at 60 days from date of November 15, amount $1,500.

21. Bought of Griffen Mfg. Co., 3/10, n/30, $2,901 (A) and $1,275.91 (B). Sold M. Shapiro & Co., 1/5, n/60, $867.50 (A) and $1,375.90 (B). Builders Supply Co. returned goods, invoice of November 16, $172.18 (A) and $114.27 (B). Received cash from B. F. Salzer for balance of invoice of November 13 less 3%.

22. Bought of American Hardware Supply Co., 3/5, n/20, $983.67 (A) and $2,875.28 (B). Sold J. Kapner, 1/10, n/60, $919.55 (A) and $1,591.25 (B). Received cash from Colonial Supply Co. for invoice of November 17 less 1%. City National Bank notified us that our account was charged with $10,000 on account of our note No. 15, due this day.

23. Bought of Norton Door Check Co., 1/10, n/60, $1,379.43 (A) and $2,519.77 (B). Discounted our note No. 20 at 6% for 60 days, at City National Bank, face of note $5,000. Paid Central Machinery & Supply Co., invoice of November 18 less 2%.

24. Bought of Simmons Hardware Co., 3/10, n/30, $3,520.18 (A) and $492.16 (B). Sold L. M. Hoffman, 2/5, n/90, $319.36 (A) and $1,580.25 (B). Received cash, account of cash sales $125.16 (A) and $114.34 (B). Paid Simmons Hardware Co., balance of invoice of November 14 less 3%. Issued our check for $10 on account of inability to make change. Received letter from Ted S. Class calling attention to overcharge of $100 in invoice of November 18 Dept. A goods due to error in addition.

25. Bought of Dixie Lumber Co., n/90, lumber for repairing buildings, $651.72 with prepaid freight $51.19 charged to us. We returned to Sundry Creditors $509.26 (A) and $722.73 (B). Sundry Customers returned goods, $215.52 (A) and $119.35 (B). Received note at 6% for 30 days, dated November 16, from L. M. Hoffman for invoice of November 11 less 2%. The bank notified us that M. Shapiro's draft due yesterday had gone to protest and that our account has been charged with protest fees of $2.50, for which we issue them our check. Received cash from J. Kapner for invoice of November 10 less 1%. Paid advertising bill $2,543.65.

27. Sold Builders Supply Co. n/60, $1,725.17 (A) and $1,836.10 (B). Received cash from M. Shapiro & Co. for protested note and fees, $1,752.50, stating that protest was in error. Paid American Hardware Supply Co. invoice of November 22 less 3%.

Instructions

November 16. Enter the Dixie Lumber Co. purchase only in the general journal, as follows:

Buildings	$782.38	
Dixie Lumber Co. (Purchase Ledger)..........		$782.38

The credit side will have to be posted twice, as indicated, to the named accounts in the purchase and general ledgers, respectively.

November 18. Enter the stock drawn for sky lights as a charge to Buildings through the sales journal. Place an "x" before the amount in the Total column.

November 20. Charge off the bankrupt Sundry Customer to the Reserve, being careful to indicate the controlling account affected.

November 23. Enter discount on $5,000 note in Sales Discount column with an "x" in front of it. Enter the note also in the notes payable journal with an "x" in front of the amount column. These are for use as guides in summarizing. Check the note in the cash book ledger folio as it will be posted from the note journal total.

November 24. Be careful about the $10 check for change. Treat the Class overcharge in the general journal. Handle the cash sales in the sales journal and, in the cash book, extend the total amount into the Sales Ledger column.

November 25. The Dixie Lumber Co. transaction is similar to that of November 16 explained above. Charge Shapiro by journal entry with the protested note. His charge for fees will come from the cash book, where the controlling account affected must also be indicated.

CHAPTER LI

APPROVAL SALES AND ADVENTURE ACCOUNTS

Approval Sales

In some lines of business approval sales are very common. Merchandising concerns frequently pursue a policy of sending goods to the homes of their customers for trial and inspection, with the privilege of return if the goods should not prove satisfactory. Publishing houses often send out books—single volumes and whole sets—with a few days' examination privilege. This class of business is often handled in a rather unsystematic fashion. Usually it is impossible to discriminate among prospective customers, since offers of this kind must be made to all alike. Consequently, the privilege is often abused by the unscrupulous.

Accounting for Approval Sales

All these things point to the urgent necessity of providing adequate safeguards in handling approval sales. The problem is rather one of organization and administration than of accounting procedure; the record-keeping presents no new difficulties and, under certain conditions, may be likened to the methods of recording outward consigned goods. In no sense are such transactions to be regarded as sales and they must not be handled in the regular sales records, as this would result in showing a profit which is not yet earned; which could not be permitted either from an accounting or legal viewpoint.

Unlike consignments, however, the price shown in the invoice is the actual selling price of the goods, and the sale if consummated is treated as a regular sale, no effort being made to keep the profit or loss on approval sales separate from the profit on regular sale transactions. Memorandum record may be made of these transactions similar to that shown for consignments.

In the retail trade, the prevailing practice in handling the charges for approval sales is to enter the charge to the customer's account when the goods are sent out and to credit the account for all returns. In this way the books keep record of all goods out on approval and provide an adequate check against lost or misplaced goods.

Where transactions of this kind are large in number, subsidiary books devoted exclusively to their record may be kept.

Tickler File Method of Handling Approval Sales

These transactions must usually be completed within a comparatively short space of time, either by acceptance or by return of the goods, and in such cases a shorter method of recording them is followed. The sales tickets or invoices covering approval sales are made with some kind of a distinctive mark—color of paper, title, etc.—to allow their easy separation from the regular sales tickets. These tickets are kept in a temporary tickler file in the order of the expiration dates of the approval period. If the sale is consummated, the ticket bearing a stamp to that effect is sent through for record as a regular cash or credit sale. If the goods are returned, the ticket may be filed as a part of that particular customer's record; in this way a cumulative record is secured which would, in some cases, give an interesting commentary on human nature. If the customer is one who makes it his or her

practice to buy on approval to secure the free use of nice wares for an evening or for some social function, the record would show it. A rigorous and unrelenting collection and follow-up system, supplemented by a full credit and information record, is the only safeguard against unscrupulous customers and oftentimes even this proves inadequate.

At inventory time all goods out on approval as shown by the approval sales file must be included in the inventory at inventory price, for the goods are still owned by the firm. As stated above, they must never be treated as sales.

Adventure Transactions

Before the day of easy transportation and communication between markets, adventure or venture undertakings were quite common. The inherent willingness to take a chance, and the desire to speculate, often led to the fitting out of cargoes of merchandise for sale in distant ports and the equipping of trading expeditions into unknown regions. Many dangers had to be met; the hazards and risks were great. Success attended many, and many met with failure. Even today this method of seeking a market has its allurements.

Single and Joint Ventures

Adventures are of two kinds, single and joint. The single adventure is merely an outward consignment by a single proprietor and would be treated as such, i.e., charged with all its costs and credited with its returns, the balance being either a profit or a loss. The joint venture is accounted for on the same principle, although it may be much more complicated. A joint venture account may be defined as the record of "commercial transactions

of a particular kind, usually of a temporary nature, entered into jointly by several parties who combine together for the purpose, contribute the capital and the services, as may be arranged, and agree to share the losses or profits in certain proportions."

Relations Between Parties

From the legal point of view, the combination under a joint venture is very similar to a partnership, the several parties to it have control as in a partnership and share profits and losses either according to contract or, in its absence, equally. Usually, in a joint venture one of the parties or an outside agent is entrusted with the entire enterprise. Speculation in stocks; the chartering of a ship for a particular purpose, a particular voyage, or a fixed period of time—these are frequently the lines of joint-venture endeavor.

Accounting for the Joint Venture

The accounting for the joint transaction is a comparatively easy matter. If the undertaking is simple, usually one account, Joint Venture, will suffice. This is debited with the costs and credited with the returns. If the enterprise is more complicated, it may be required to set up a number of separate accounts, but the summary or clearing account for these will still exhibit costs set over against returns. If the partners are all in the same city and have access to the records, one set of accounts is all that is necessary. Where the partners are in different places, each should keep a record of all transactions as reported by the manager of the venture. Since the manager reports all transactions to each of the parties, the Joint Venture accounts as kept by the different partners will all be the same.

The other accounts affected by the joint transactions

will either be the same or reciprocal. Upon the inception of the venture, some of the partners having contributed cash, others merchandise, still others facilities, services, etc., the Joint Venture account is charged with all contributions and each partner is credited. If the venture is managed by one of the partners, instead of a credit to his own personal account, his cash or merchandise account would receive the credit. Expenses incurred are charged to the joint account and credited to the partner paying them. All sales made and collected are credited to the joint account and charged to the partner retaining the money.

Interest Allowances and Charges

Because some partners may have made larger contributions than others, the agreement may provide that interest be credited the partners on their contributions. On the other hand, it frequently happens that one or some of the partners have the use of the moneys received from joint sales until date of settlement of the venture, and the agreement may provide that interest shall be charged to the ones retaining the collected funds. This can be accomplished by charging the joint account and crediting the partners from the dates of their contributions to the date of settlement, and by charging the partners retaining joint funds and crediting the joint account from the date when the funds come into their possession until the settlement date. A salary or a commission may be allowed the managing partner or partners. This also is a charge to the joint account and a credit to the partner.

Distribution of Profits

After all transactions have been completed and all charges and credits made, the joint account will show by

its balance the net profit or loss. This is distributed among the partners in agreed ratio or in equal ratio in the absence of agreement. After this is done only the partners' accounts remain, some with debit and others with credit balances. The managing partner should collect the debit balances and remit to those with credit balances, thus making a complete settlement of the joint undertaking.

Should the fiscal period of any of the partners close during the term of the venture, conservatism would generally require that his own accounts do not show a profit on the sales made to date, on the theory that losses on the incomplete portion may wipe out any profits on the completed portion. This is because the joint undertaking is considered as a whole and inseparable transaction and not as composed of numerous separate sales. The element of risk is always an important factor in undertakings of this sort. However, there might be circumstances under which the taking of at least a partial profit could be justified. Assuming that no profit is taken, the joint account becomes a balance sheet account at closing, asset or liability according as costs have been more or less than the sales as on the date of closing.

Joint Venture Accounts Illustrated

An illustration will bring out the salient points in the above method of handling.

Problem. A, B, and C enter a joint venture to Mexico, with C as manager. A and C contribute merchandise at $5,000 and $8,000 respectively, and B $11,000 cash for the purchase of additional merchandise. C is to receive 3% commission on sales. C pays freight, duty, and insurance of $890 and buys merchandise with B's contribution. He makes sales, according to reports sent by him to A and B,

aggregating $30,000, and holds the amount in his possession one month till settlement. The investment period was six months. Interest is reckoned at 6%. A, B, and C share profits in the ratio of their original contributions. The following entries show the record of the above transactions on B's and C's books.

At the beginning of the venture the record would be:

On B's books:

(1)	Joint Venture, A & C, to Mexico............	$24,000.00	
	A		$5,000.00
	Cash		11,000.00
	C		8,000.00
	To set up the venture transaction.		
(2)	Joint Venture, A. & C, to Mexico..........	890.00	
	C		890.00
	Freight, duty, etc., paid by C.		

On C's books:

(1)	Joint Venture, A & B, to Mexico............	$24,000.00	
	A		$5,000.00
	B		11,000.00
	Purchases		8,000.00
	(As above.)		
(2)	Joint Venture, A & B, to Mexico..........	890.00	
	Cash		890.00
	(As above.)		

At the time of settlement, on B's books:

(1)	Joint Venture, A & C, to Mexico............	$1,620.00	
	A		$150.00
	Interest and Discount................		330.00
	C		1,140.00
	6% interest on original contributions of each partner for 6 months; 3% commission to C on sales.		
(2)	C	30,150.00	
	Joint Venture, A & C, to Mexico......		30,150.00
	6% interest charged C on $30,000 for 1 month; C charged with his collections from sales $30,000.		

On C's books:

(1)	Joint Venture, A & B, to Mexico	$1,620.00	
	A		$150.00
	B		330.00
	Interest and Discount		240.00
	Commission Earned		900.00
(2)	Cash	30,000.00	
	Interest and Discount	150.00	
	Joint Venture, A & B, to Mexico		30,150.00

On the records of all the partners the Joint Venture account shows a credit balance, i.e., a profit of $3,640, the distribution of which would be as follows:

On B's books:

Joint Venture, A & C, to Mexico	$3,640.00	
A		$758.33
Profit and Loss		1,668.34
C		1,213.33
To distribute profits on the venture in the agreed ratio 5:11:8.		

On C's books:

Joint Venture, A & B, to Mexico	$3,640.00	
A		$758.33
B		1,668.34
Profit and Loss		1,213.33

B's accounts now show a balance due A of $5,908.33; a claim against C for $18,906.67; his own share therefore being the difference, or $12,998.34.

C's accounts show a balance due A of $5,908.33; due B $12,998.34; the remainder of the joint income $11,243.33 [$30,150 — ($5,908.33 + $12,988.34) = $11,243.33], being his own share, offset, of course, by a $150 interest charge.

The accounts on each partner's books with his copartners are not ordinary asset and liability accounts but more of the nature of capital accounts and might be entitled "A, Contribution," "B, Contribution," etc.

Practice Data*

(*Assignment for Chapter LI*)

November 28. Bought of Griffen Mfg. Co., 3/10, n/30, $1,193.69 (A) and $2,987.12 (B), with prepaid freight charged to us of $193.72 Received cash from Lowell & Meservy for invoice of November 14 less 1%. Made partial payment on sky light contract $192.50.

29. Bought of Sundry Creditors, 3/10, n/30, $8,084.29 (A) and $11,057.08 (B). Sold Sundry Customers, 2/5, n/30, $21,491.98 (A) and $22,821.69 (B). Received note at 6% for 2 months, dated November 18, from A. Mishkin for invoice of November 8 less 1%. Received cash from Sundry Customers for invoices amounting to $46,875.10 less discount of $910.10. Received cash from sale of office safe $150. The safe had cost $250, this year's depreciation being estimated at $15. Reimbursed petty cashier for vouchers turned over, $134.75, and distributed same, $75.80 to Sales General Expense, $10.19 to Office Expense, and $48.76 to General Expense. Paid Sundry Creditors, invoices of $18,697.23 less $317.13 discount. Paid salesmen's salaries $3,750, traveling expense $3,675.80, sales general expense $672.50, general salaries $3,971.20, interest and bank expense $115.75, and general expense $6,127.80. Charge Buildings, through the Journal, with $35 of the general salaries paid our own mechanic for work on the sky lights.

Instructions

Payment on sky light contract is in favor of the general contractor, not the Dixie Lumber Co.

Study the office safe sale transaction carefully. Make full explanation of it in the journal.

Summarize the various subsidiary journals carefully, taking note of any extraneous items. In the Notes Payable summary treat the $5,000 note separately as it is not a charge to "Purchase Ledger." In the cash book, its discount must be listed separately in the summary entry. In summarizing the cash receipts you must subtract the November 1 balance before obtaining the correct charge to the bank. In the sales and purchase journals the Out-Freight and In-Freight enter into the summaries. This is true also of the Sales and Purchase Discounts in the note journals.

*See Practice Data for Chapters XLVII, XLVIII, and L. Figures at left margin indicate day of month.

CHAPTER LII

ACCOUNTS CURRENT

Definition

An account current in its broadest sense is an account of current transactions. In a technical sense, it is an open personal account, one with an outstanding balance. Frequently accounts are allowed to run on between two persons, recording transaction after transaction with partial or full settlement at times but with no intention of closing the account. A principal may have constant dealings with his agent or representative, making periodical payments on account or making remittances to be used as needed by the agent. The agent may make purchases for the account of his principal, paying the bill out of his own funds. He may use for his own transactions any surplus funds of the principal in his possession. An account showing transactions of this sort is an account current.

Interest on Balances

Very often it is agreed between the parties that interest is to be charged on the debit balances and allowed on the credit balances. It was formerly the practice in some lines of trade to charge interest on all overdue customers' accounts. Frequently today invoices carry a statement to that effect. More frequently, however, the policy is not enforced. The customer's patronage, even if payments are not so prompt as might be desired, is worth more than the interest would amount to, and the enforcing of the demand might mean loss of the patronage.

Joint Venture Accounts

In the case of joint ventures discussed in the preceding chapter, a condition analogous to this was mentioned wherein the joint account was charged and the contributing partners' accounts were credited with interest, while the managing partner was charged and the joint account credited with interest on all joint funds retained in his possession.

Partners' Accounts and the Account Current

Occasionally, also, in partnership adjustments at the close of a fiscal period, the agreement may require the business, i.e., the partnership, to allow each partner credit for interest on his investments and charge him with interest on his withdrawals. Each partner's account is treated very much as an account current of the business when such adjustments are prescribed. Thus, while the old account current as formerly understood and applied to the ordinary customer and creditor relationship is now very seldom encountered, the principle of it is met with frequently enough to demand explanation and illustration. No special form is necessary for the stating of an account current; the interest calculations on the various balances can be made outside the account and only the net result be embodied in the account. A form of account is shown on page 494, however, which exhibits all necessary data on its face. Take the following account on which 5% interest is to be charged and allowed.

B. I. PERKINS, CURRENT ACCOUNT

1916			1916		
July 4	Cash	$1,250.00	June 4	Balance	$600.00
Aug. 11	Note 60 da., no int.	1,500.00	July 4	Mdse. n/30......	1,400.00
			Aug. 3	Mdse. n/30......	1,000.00
Nov. 11	Cash	1,000.00	Oct. 2	Mdse............	2,100.00
Dec. 7	Cash	400.00	Dec. 4	Mdse...........	800.00
Dec. 10	Rtd. Goods of Dec. 4.......	50.00			

Adjusting the Current Account

Adjustment of such accounts is usually made periodically. Referring to the illustration shown on page 494, the interest calculation is made counting the exact number of days from each "date of value" to and including December 31. Interest is figured, for the sake of ease of calculation, on a 360-day basis. A 365-day basis would be more accurate and this is often done on current accounts between banks. The "date of value" is the date from which interest may be equitably charged or allowed. For example, in the above account, the credit for merchandise purchased on July 4 but with a credit allowance of 30 days, may not equitably be allowed till 30 days thereafter, or August 3. On the debit side, the note for $1,500 dated August 11, at 60 days with no interest, cannot be equitably counted until it comes due, i.e., on October 10. Similarly, the "date of value" on December 10, for the goods returned of the transaction of December 4, must be reckoned as of the same date as the original transaction, for only a portion of the full credit set up is allowed to remain.

In the above problem, the credit interest exceeds the debit by $35.80. This amount is therefore brought as an additional credit into the account. The account as now adjusted will be sent to B. I. Perkins for his verification. When formally approved, or if no objection is made to it after a reasonable length of time, the account is balanced and it becomes now what is termed an adjusted account. This periodic adjustment makes possible the localization of disagreements and their settlement while the facts are still fresh in mind. Its effect, however, is to produce a slight compounding of interest unless the balance is immediately settled.

Another method of making the interest calculation is on the basis of the new balance of the account after each trans-

B. J. Perkins, Current Account

DATE		AMOUNT	DATE OF VALUE	DAYS	INTEREST	DATE		AMOUNT	DATE OF VALUE	DAYS	INTEREST
7/4	Cash	1250 00	7/4	180	31 25	6/4	Balance	600 00	6/4	210	17 50
8/11	Note 60 d. no int	1500 00	10/10	82	17 08	7/4	Mdse. n/30	1400 00	8/3	150	29 17
11/11	Cash	1000 00	11/11	50	6 94	8/3	" n/30	1000 00	9/2	120	16 67
12/7	"	400 00	12/7	24	1 33	10/2	"	2100 00	10/2	90	26 25
12/10	Retd. as of 12/4	50 00	12/4	27	19	12/4	"	800 00	12/4	27	3 00
12/31	Balance of interest				35 80	12/31	Interest	35 80			
	Balance of the account	1735 80									
		5935 80			92 59			5935 80			92 59
						1/1		1735 80			

Form of Adjusted Current Account

action and the length of time it remains unchanged, i.e., until the next transaction changes the balance. This method follows somewhat the method illustrated in Chapter XXXIV for division of partners' profits on the basis of the amount of the investment and the length of time invested; but under this method it is not possible to make so condensed and apparent a statement of account as by the method illustrated in full above.

It sometimes happens that the "date of value" may fall beyond the settlement date, as where the term of credit throws the time of payment far enough ahead that payment cannot be demanded till after a periodic settlement time. The effect of such a condition is to reverse the interest charge for the period beyond the settlement date to an interest credit or vice versa. The method of averaging accounts or equation of payments, as it is sometimes called, may be used to advantage here. Explanation and illustration of this method are given in Chapter LVII.

The Bank Account an Account Current

The bank account is a good example of the current account. The periodical adjustments make possible a comparison of the record kept by the depositor with the record kept by the bank. When the balanced pass-book, with cancelled checks, is returned to the depositor, or when the statement of account is rendered by the bank, the record kept by the depositor—as shown by his check book stubs or by the bank column in his cash book—will not usually show the same balance as that indicated on the bank's statement, and adjustment or reconciliation is necessary to check the accuracy of the statement. In Chapter XXXV regarding the handling of cash, the policy was recommended of depositing all receipts and paying only by check. A cash book kept under that plan, making use of a net cash column

on both sides, does not need an additional column for the bank record because everything shown in the net cash columns has either been deposited in the bank or paid out by check. The cash book balance, therefore, should be the same as the bank's balance. If the record of the bank account be kept only on the check book stubs or interleaves, then this balance should be the same as the bank's. But, however kept, there will almost invariably be a few outstanding checks which the depositor's cash book or check book shows as having been issued, but which have not been presented to the bank for payment at the time the statement of account is rendered and which therefore are not included in it. This brings about a difference which must be reconciled.

Reconciliation of Bank Balance

Two methods of reconciliation are used. The one brings the bank's balance into agreement with that of the depositor; the other starts with the depositor's balance and brings it into agreement with that of the bank. The first step in the reconciliation is to discover which of the checks issued by the depositor have not been paid by the bank. This is done by arranging the returned checks in numerical sequence and comparing these with the depositor's record of checks issued. Usually the total of these few unpaid checks will be equal to the discrepancy between the two records, and so will reconcile them.

The following problem is given to illustrate the above discussion:

On March 20, at the close of the day, the bank's statement showed a balance of $1,525.14. The depositor's record on the same date showed $604,19. The following checks were outstanding: No. 529B, $214.50; 542B, $379.60; 557B, $119.40; 581B, $75.20; and 992A, $132.25.

Reconciliation statement, as on March 20, 1917:

Bank balance as per bank's statement			$1,525.14
Outstanding checks:			
	No. 992A	$132.25	
	529B	214.50	
	542B	379.60	
	557B	119.40	
	581B	75.20	920.95
True balance as per cash (or check) book			$604.19

Other method:

True balance as per cash book			$604.19
Outstanding checks:			
	No. 992A	$132.25	
	529B	214.50	
	542B	379.60	
	557B	119.40	
	581B	75.20	920.95
Bank balance as per bank's statement			$1,525.14

Other Reconciliation Factors

Oftentimes other items than those shown must be taken into consideration when reconciliation is made. Where several bank accounts are kept and a check register—in addition to the cash book—is used to keep record of the accounts with the various banks, it may happen that checks drawn on one bank are wrongly charged to another; that checks drawn, or deposits made one day, are not credited until the next; that certain drafts deposited with the bank for collection are not credited to the depositor's account until collection is made, whereas the depositor debited the bank at the time of the deposit; again it may be that the item of bank's charges for collection has not yet been recorded; or that interest on deposit balances has not been credited, etc. All such items must be considered when reconciliation is made. Where there are many of these adjustment items

to be taken account of, it may be necessary to list them in formal schedules under such heads as:

1. Bank charges, we do not credit.
2. Bank credits, we do not charge.
3. We charge, bank does not credit.
4. We credit, bank does not charge.

There is not usually so much difficulty in reconciling the bank account, but where several bank accounts are maintained, it is easy to misplace debits and credits and a formal statement of reconciliation should always be made and kept as a part of the record. This reconciliation should be made every time a statement is received from the bank. The frequency of asking for a statement of account from the bank depends somewhat upon the volume of transactions handled through the bank, but it should be secured at least every month and particularly whenever formal statements of profit and loss and the balance sheet are made up.

Reconciliation Statement a Permanent Record

The reconciliation statement should be made as a permanent record. A customary place of record is on the check stub of the same date. Where a check register is used, it should be made a part of the record there. Occasionally, it is incorporated in the cash book. Wherever made it should be easily available for proof at a subsequent period. When reconciliation is to be made at a past date, i.e., at a time subsequent to the date on which reconciliation is desired, the bank's cancellation date on the returned checks must be used to determine what checks were outstanding on that date.

Reconciling Other Accounts

Occasionally the dealings between two firms located at a distance from each other may be such that items are

in transit one or both ways at the time when statement of account is rendered. If this is the case, the methods of reconciliation applied above to the bank account may have to be used before agreement or comparison of the two records can be effected.

Practice Data*

(*Assignment for Chapter LII*)

Post completely and take a trial balance of the general ledger, recording it on page 7 of your general journal. When posting customers' and creditors' accounts, make sure that the corresponding controlling accounts will receive, either in totals or in items, the same amounts. Prove your sales and purchase ledgers and record the proof formally on page 8 of the general journal, i.e., make a list or schedule of the accounts and show the list totals as agreeing with their respective controlling account balances in the general ledger trial balance.

*See Practice Data for Chapters XLVII, XLVIII, L, and LI.

CHAPTER LIII

SAFEGUARDING CASH; INSTALMENT SALES; PROPORTION; BOOK INVENTORIES

Safeguarding the Cash

General Principles

As stated in Chapter XXXV, a fundamental principle to be observed in handling the cash is to secure two independent records of receipts and disbursements. This is usually accomplished by requiring that all moneys received shall be deposited and that all disbursements shall be made by check. In this case the bank's record acts as a check against the record kept by the customer. This is good so far as it goes and acts as a check on cash transactions *after* the record is made, but does not insure that the cash book record will be made correctly in the first place. There are ways in which cash received may never get into the cash book, going instead into the cashier's or salesmen's pockets. To prevent this entirely, no system or method has ever yet been devised. Every system must rest in some place upon the integrity of the human agent, and will fail of its full efficiency and intended results if the agent fails in the trust imposed in him. Every effort should be made to prevent both petty thievery—the abstraction of small sums whenever opportunity presents itself—and systematic robbery mapped out and planned with infinite care as to the details. Only everlasting vigilance and a system of "checks" will secure satisfactory results, as occasionally it is the *trusted* employee who is not true to the trust placed in him.

Internal Check

By internal check is meant the method by which employees check the records of one another, and entire control does not rest in any one clerk. Thus a system of record-making which combines the work of the cashier and bookkeeper under one clerk or which gives the cashier access to the ledgers, is one which invites dishonesty. Where the cashier has entire control of the cash, and, besides, opens the incoming mail, makes up his daily deposits, has his pass-books balanced periodically, and files the cancelled checks, opportunity is offered him to abstract cash and falsify his records. But where detailed daily reports of the cash must be made to the manager, treasurer, or other officer; where the cashier is denied access to the records—except his own cash record—and where his record is subject to periodic proof; where the mail is opened first and receipts listed by an independent clerk; where a careful system of proving receipts from cash sales and of allowing no unauthorized deliveries over the counter is employed; where every member of the office force is required to take a vacation during which time his work and records are cared for by other employees —this plan of interior organization effects a very satisfactory system of safeguards and internal checks. All of these devices and systems are applicable in full only in large concerns where minute division of duties is possible. In smaller concerns where many duties have to be combined under one person, the problem of safeguarding the cash and providing other measures to prevent fraud of various sorts is more difficult. In such a concern, at least the cash received through the mail should be listed first by someone other than the cashier or bookkeeper, and the daily deposit slip should be compared with this list to see that all such items are included. The cash received from cash sales should also be proved daily against the sales tickets.

Statement of Receipts and Disbursements

Where a periodic report of cash is made, it is usually shown by means of a statement of receipts and disbursements. This statement is an abstract, a summary, of the cash book, showing the total receipts from various sources and the causes of the disbursements and their totals. A simple form is given below:

STATEMENT OF RECEIPTS AND DISBURSEMENTS
For Week Ending...........

Receipts:		
Cash Sales	$10,129.40	
Accounts Receivable	25,464.50	
Notes Discounted	1,500.00	
Miscellaneous: Interest, Rebates, etc	519.20	
Total this week	$37,613.10	
Previous balance	2,319.40	$39,932.50
Disbursements:		
Accounts Payable	$28,492.10	
Salaries and Wages	4,193.25	
Delivery Equipment	250.00	
Advertising	1,300.00	
Miscellaneous: Interest, General Expense, etc.	920.15	35,155.50
Balance on hand as per cash book		$4,777.00

To assist in checking past deposits, often an itemized record of daily cash receipts is kept, analyzed as to gold, silver, currency, notes, and checks. To be of value this record should be filed with the daily deposit tickets and be available for comparison at a later time.

INSTALMENT SALES

The Problem Involved

The sale of goods with the privilege of payment in instalments is a well-recognized custom in certain lines, par-

ticularly in the furniture, piano, book subscription, and similar businesses. To protect the seller, the sale contract almost invariably contains a clause to the effect that title to the goods shall remain in the seller until final payment has been made, that failure to pay any instalment when due shall result in the cancellation of the contract, and that in such case the goods shall be returned to the seller. Experience in this class of sales shows that a large number of contracts are forfeited with or without return of the goods. Where the goods are returned, there is frequently a large loss through depreciation, the returned goods having to be treated as second-hand. In some instances, to enforce return of the goods might entail greater expense than loss of the goods themselves. These are, of course, questions of business policy rather than of accounting, although the results shown by the accounting department enter into their settlement.

Accounting for Instalment Sales

The accounting for sales under the instalment plan is not different from accounting for other sales. They are, in their first record, charged to the customer and credited to Sales or various departmental sales accounts. If the goods are forfeited and returned, the record is to Returned Sales for the debit and the customer is credited for the unpaid instalment. Whatever profit or loss there may be on the transaction will be shown in the Profit and Loss account when the inventory is taken and the returned goods are appraised. If the customer fails to pay his instalments but does not return the goods, the loss is one from bad ebts.

Separation of Instalment from Regular Sales Records

Where both instalment and regular sales are made, as is usually the case since few concerns limit their activities

entirely to the instalment method, it is best to keep a separate instalment ledger with a controlling account, called "Instalment Accounts Receivable" or "Instalment Contracts." The two classes of customers should be kept separate because of the greater liability to loss in the one class than in the other. Before profits for the period can be correctly determined, it is necessary to estimate the probable loss on contracts closed during the period, and in the balance sheet separate showing should be made of the loss from this class of accounts receivable and that from the other class. The estimated loss on the instalment accounts is, of course, an experience figure, but a conservative policy requires that the amount should be fairly liberal.

Delinquency Records

Forfeiture of contracts is not usually enforced upon first failure to pay an instalment, but such delinquencies should be brought to the attention of the management and particularly of the credit and collection department. Delinquency may even be recorded in the books by transfer from the Instalment Accounts Receivable to a "Delinquent Instalment" account. This makes an up-to-date analysis of the Instalment Receivable account and so furnishes a better basis for estimate of loss from bad debts than where no separation is made.

Chief Considerations in Handling Instalment Sales

From the accounting standpoint, the chief question is that of making the estimate for loss from uncollectible accounts. From the standpoint of financial management, instalment sales present the problems of passing on credits before taking the risks and afterwards of pushing collections so as to prevent forfeiture and consequent loss wherever possible. It is not purposed to treat of these

phases here. For such the student is referred to standard works on credits and collections.

Proportion

Simple and Weighted

Proportion is defined as an equality of ratios. Thus, if the ratio of a to b is the same as the ratio of c to d, this relation may be expressed as follows:

$$\frac{a}{b} = \frac{c}{d} \text{ or } a : b = c : d$$

the fractional form being preferred. In accounting it is often required to divide amounts in certain ratios, as when profits must be apportioned among partners, when insurance, taxes, and other expense charges must be distributed over departments, etc. This is usually entitled "apportioning." It is not necessary to illustrate simple proportion, but a problem in "weighted proportion" will be given here.

Apportion an insurance charge of $1,000 over departments A, B, and C according to the property values in those departments, taking account of the fact that the rate on A is double that on B and C. The property values are: A, $10,000; B, $15,000; C, $35,000.

The proper basis for distribution cannot be found, as in simple proportion, by an addition of the values in the departments. Before addition, the value in A must be weighted by 2, i.e., doubled. This gives a basis of $70,000 ($20,000 for A + $15,000 for B + $35,000 for C = $70,000). Of the $1,000 insurance cost, department A will have to bear 20/70; B 15/70; and C 35/70. The charges will be therefore:

A,	20/70	of	$1,000	or	$285.71
B,	15/70	of	1,000	or	214.29
C,	35/70	of	1,000	or	500.00
					$1,000.00

Apportioning Freight Charges

In-freight and cartage are treated as additions to the cost of goods bought; consequently, at inventory time it is necessary to add the correct amount of in-freight to the cost of goods on hand. However, it is seldom possible to apply the freight costs directly to each unit of product on hand and yet theoretically this should be done. Usually the ratio of freight costs to the total amount of purchases during a given period is taken as the basis for adding freight to the inventory. Thus, if that ratio has been 5% for the period, a commodity costing $100 would be valued at $105 for the inventory. Thus, the freight expense is deferred.

This usually is deemed sufficiently accurate for most purposes. Where departmental records are kept, or where accurate factory costs are required, a closer apportioning is sometimes required. The freight classifications are such that the rates are not proportionate to the *values* of the goods; but other factors such as weight, kind of goods, method of crating, etc., all enter into the freight rate. Of these, the only factor which is easily obtainable is the weight. A distribution of freight on the basis of *value* and *weight* has been suggested—a weighted proportion method of apportionment. This, of course, requires an involved calculation which is usually "shied" at by bookkeepers and would not be necessary except where very accurate and detailed costs are required.

Book or Estimated Inventories

Some trading concerns desire an approximation of their profits every time a trial balance is taken. Usually it is impracticable to take inventory every month, and, where no stock records are kept, it is necessary to estimate the goods on hand in order to approximate the profits. If ac-

curate record has been kept of gross profits for a number of years past, it is possible to make a close estimate of goods on hand. In an established business, conditions are usually fairly well standardized and vary little from year to year.

Thus, if in the past there has been an average gross profit of 40% on the total amount of the sales, 60% on sales must represent the cost of goods sold. The cost of goods sold deducted from purchases will give the approximate value of goods on hand. If sales have been $20,000, and purchases and opening inventory added, amount to $22,500, on the above basis cost of goods sold must be $12,000 (60% of $20,000). Therefore, goods now on hand amount to $10,500 ($22,500—$12,000). Where conditions are well standardized, it is surprising how little deviation there is of the estimated inventories from the actual physical inventories.

The method of the estimated inventory makes possible a showing of balance sheet and profit and loss statement at any time a trial balance is taken; but it is never a safe guide for a balance sheet intended to show true condition for a six months' or a year's period. It is all right, if carefully handled, for interim periods, but only a physical inventory can give accurate and true results.

PROBLEM

(Assignment for Chapter LIII)

The Carney-Edmunds Co. general ledger shows the following trial balance for the fiscal year ending December 31, 1916:

Land	$10,000.00
Buildings	9,000.00

Office Furniture & Fixtures	500.00	
Store Furniture & Fixtures	2,200.00	
Delivery Equipment	2,000.00	
Inventory Department A	4,000.00	
Inventory Department B	5,000.00	
Department A, Purchases	20,000.00	
Department A, Purchase Returns & Allowances		$ 1,000.00
Department B, Purchases	28,000.00	
Department B, Purchase Returns & Allowances		2,000.00
Department A, Sales		25,100.00
Department A, Sales Returns and Allowances	800.00	
Department B, Sales		38,000.00
Department B, Sales Returns & Allowances	1,700.00	
Taxes	840.00	
Insurance	500.00	
Office Expense	450.00	
General Expense	200.00	
In-Freight	500.00	
Out-Freight	100.00	
Horse-keep	400.00	
Sales Discount	300.00	
Purchase Discount		890.00
Interest & Discount	125.00	
Collection & Exchange	25.00	
Printing & Stationery	100.00	
Advertising	1,500.00	
Traveling Expense	750.00	
Salesmen's Salaries	5,000.00	
General Salaries	6,000.00	
Capital Stock		50,000.00
Surplus		10,000.00
Trade Customers	25,000.00	
Trade Creditors		3,300.00
N. Y. National Bank	7,400.00	
Petty Cash	100.00	
Notes Receivable	2,800.00	
Notes Payable		2,000.00
Mortgage Payable		3,000.00
	$135,290.00	$135,290.00

Draw up pro forma balance sheet and profit and loss statement, taking account of the following adjustments and inventories:

Allow: 2% depreciation on buildings.

10% depreciation on store and office furniture.

16 2/3% depreciation on delivery equipment.

2½% of Trade Customers and Notes Receivable for bad debts.

Defer $125 insurance and $200 advertising.

Salesmen's salaries $75, interest on mortgage and notes payable $120, and bill for repairs to building $62.50, are now accrued and unpaid.

Interest earned but not due amounts to $23.

Stock of merchandise now on hand is:

Department A, $6,340.20.

Department B, $9,871.30.

Apportion the in-freight to the two departments on the basis of gross purchases.

Charge 90% of the insurance cost to Selling.

Handle the depreciation on building as a general administrative expense.

A 10% dividend is declared and paid.

Instructions

In the solution of the above problem make use of the working sheet illustrated in Chapter XLIII. From that draw up the formal statements.

Balance Sheet. Where the number of accrued and deferred items is small, they may be shown in detail on the face of the balance sheet or in attached schedule, as preferred.

Profit and Loss. Where the record of the period's business has been made by departments, it is desirable that the summary for the period show departmental results, at least, as far as the gross profit stage. To get rid of the detail on the face of the statement, schedules may be appended showing such items as Cost of Goods Sold, the group of Selling Expenses, the group of General Administrative Expenses, etc. Such a statement of profit and loss, supported by schedules, is called a condensed profit and loss statement. A condensed profit and loss statement for a departmental business is shown on the following page. Only Schedule 1 is given; the other schedules would be merely lists with their totals shown.

Exhibit B

JACKSON EDWARDS COMPANY

STATEMENT OF PROFIT AND LOSS, DECEMBER 31, 1916

	Department A	Department B	Total
Sales	$100,000.00	$150,000.00	$250,000.00
Less Returns & Allowances	5,000.00	6,000.00	11,000.00
Net Sales	$95,000.00	$144,000.00	$239,000.00
Cost of Goods Sold (Schedule 1)	60,000.00	90,000.00	150,000.00
Gross Profit	$35,000.00	$54,000.00	$89,000.00
Selling Expenses (Schedule 2)		$35,000.00	
General Administrative Expenses (Schedule 3)		20,000.00	
Financial Management Expenses (Schedule 4)		5,000.00	60,000.00
Net Profit			$29,000.00

Exhibit B—Schedule 1

COST OF GOODS SOLD

	Department A		Department B		Total	
Inventory, January 1, 1916		$12,000.00		$18,000.00		$30,000.00
Purchases		60,000.00		87,500.00		147,500.00
In-Freight		3,500.00		5,000.00		8,500.00
		$75,500.00		$110,500.00		$186,000.00
Deduct:						
Purchase Returns	$2,000.00		$3,000.00		$5,000.00	
Inventory, December 31, 1916	13,500.00	15,500.00	17,500.00	20,500.00	31,000.00	36,000.00
Cost of Goods Sold		$60,000.00		$90,000.00		$150,000.00

CHAPTER LIV

BALANCING METHODS

The "Fool-Proof" Trial Balance

Double-entry bookkeeping is never satisfied with anything short of absolute proof of the mathematical accuracy of the work. Often such proof is a very difficult thing to secure. There has not yet been devised—and, in the nature of things, never will be—any so-called royal road to the trial balance. Yet one often sees claims put forth that there is no longer any need for trial balance troubles. The use of certain methods, which are disclosed only upon payment of fees in proportion to the advantages claimed for them, makes it possible, according to their devisers, to take a trial balance within an incredibly short time or to do away with trial balances altogether. As a matter of fact, satisfactory results can be obtained only by habits of accuracy and by proving the work done wherever possible. Some methods found useful in searching stubborn errors will be explained in this chapter.

Ledger Analysis

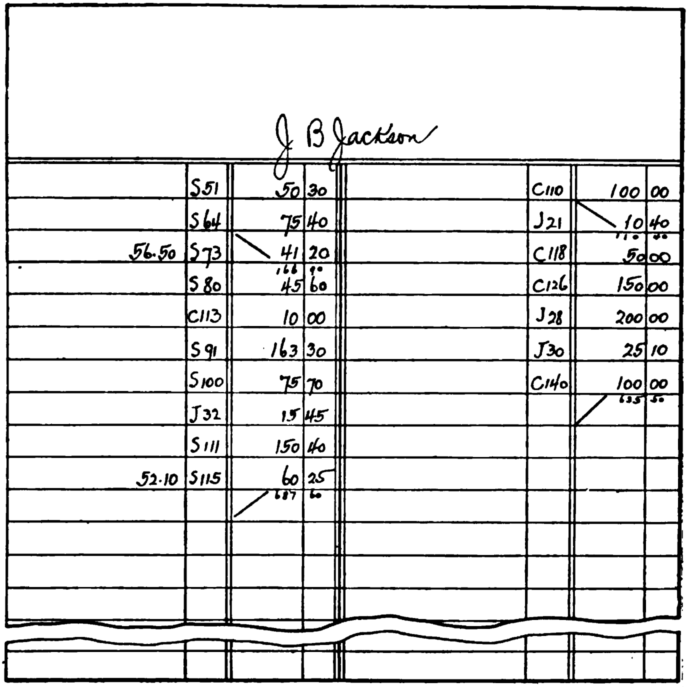
By ledger analysis is meant an analysis of postings on the basis of books of original entry, i.e., on the basis of all journals whose record is transferred to the ledger. The process of making such an analysis is somewhat as follows: The ledger must be gone through carefully and for each account the last debit and credit figures which entered into the last *correct* trial balance must be marked distinctly so as not to be included in the analysis. If the analysis is for an interim period, the first debit and credit items belonging

to the next period should be marked in a similar way, as shown in the illustration: Care must be exercised here as the "date" is not always a safe guide. The use of subsidiary journals with one summary posting to offset many detailed contra postings and inaccurate dating of the summary posting often make the "date" an uncertain guide. Care should therefore be exercised so that the points marked include a complete, i.e., a debit and credit, posting of every journal.

Procedure of Analysis

The content of each account between the marked points is now analyzed according to the journals from which the postings were made. Usually analysis paper is used with debit and credit columns headed for each journal. All debits in the account posted from the journal are entered in the debit journal column of the analysis sheet, all cash debits in the debit cash column, all sales journal debits in the debit sales journal column, etc. Similarly, the credit postings in the account are entered in the proper credit columns of the analysis sheet. Each item in the account should be checked or otherwise marked when transferred to the analysis sheet. Illustration of the analysis sheet is given on page 514.

When the various accounts have thus been analyzed, there should remain no unchecked items in the period analyzed, unless there have been transfers between accounts made directly on the face of the ledger. If this has been the practice, an additional heading with debit and credit columns, entitled "Ledger Transfers," should be set up on the analysis sheet. *Every* account in the ledger is analyzed in the same way. To make sure that the method is understood, an account and its analysis are shown here:



J B Jackson

	S51	50	30	C110	100	00
	S64	75	40	J21	10	40
56.50	S73	41	20	C118	50	00
	S80	45	60	C126	150	00
	C113	10	00	J28	200	00
	S91	163	30	J30	25	10
	S100	75	70	C140	100	00
	J32	15	45			
	S111	150	40			
52.10	S115	60	25			

Account Marked for Analysis

The Analysis Sheet

It will be noticed that only the period between the two diagonal marks \ and / is under analysis. Accounts which have been closed but are within the period under analysis must, of course, be included. When all accounts have been analyzed, the columns of the analysis sheet are footed. For each journal the footings of the debit and credit columns should be equal. A difference would indicate that there is an error in the postings from that particular journal. In this way the error is localized and only these postings need to be checked individually.

The cash book columns in the analysis sheet may need some explanation. If no cash account is kept on the ledger,

LEDGER ANALYSIS SHEET

ACCOUNT	L.F.	GENERAL JOURNAL Dr.	GENERAL JOURNAL Cr.	SALES JOURNAL Dr.	SALES JOURNAL Cr.	CASH BOOK Dr.	CASH BOOK Cr.	PURCHASE JOURNAL Dr.	PURCHASE JOURNAL Cr.	LEDGER TRANSFERS Dr.	LEDGER TRANSFERS Cr.
		15 45	200 00	45 60		10 00	50 00				
			25 10	163 30			150 00				
				75 70			100 00				
				150 40							
				60 25							

Ledger Analysis Sheet

the balance of the cash book for the period will have to be entered on the analysis sheet before equality of the cash columns will be shown. With the exception of the items transferred to the analysis sheet from the cash account—where a cash account is carried in the ledger—all items in the cash debit column of the analysis sheet represent in the cash book, credits to certain accounts, and those in its credit column represent debits to certain accounts. The entries to the cash analysis column from the ledger cash account, showing on its debit cash receipts and on its credit cash disbursements, must bring about the equilibrium. The column total, however, will not represent cash receipts and cash disbursements respectively, but the total of each column will be the sum of both receipts and disbursements; whereas the totals of the other columns are equal to the totals of the corresponding journals for the period. The cause of this lies in the fact that the two cash columns on the analysis sheet really cover two independent journals, viz., the cash receipts and the cash disbursements journals.

If the debit and credit totals of corresponding columns agree, that is proof of equilibrium in the postings from that book, but, unless these column totals also equal the total of the corresponding journal, there is evidence of the omission from the ledger, both on the debit and on the credit side, of items recorded in the journal. Thus the ledger analysis serves also as a check against omissions; but when used for that purpose, account must be taken of duplicate entries in the various journals, such as cash sales entered both in the cash and sales journals but posted only from one of them.

Use of Ledger Analysis

All that is claimed for the ledger analysis is that it localizes the error, if it is an error in posting, and so makes the work of searching for it less haphazard and renders

unnecessary a checking of all postings in the ledger. All of the means previously explained should be exhausted before resort is had to this method. If the previous trial balance, i.e., the one at the beginning of the analysis period, was correct and the ledger analysis shows no errors in posting, then certainly the trial balance for the end of the analysis period must balance. If not, the error is an error on the face of the ledger and its computations must be proven.

The Slip or Reverse Posting System

As indicated before, it is better to post carefully and accurately in the first place than to hunt for errors afterwards. A method of proving daily postings known as the slip or reverse posting system is used with success in many places. Formal slips of any convenient width and length are provided, one for the debit and one for the credit of each book from which postings are made. The debit slips may be easily distinguished from the credit slips by the use of different colors. The slips are ruled only with money columns and each slip bears the title of its journal. Reverse posting is made on the slip from the items posted to the ledger. Thus, when posting the debits from the general journal, the general journal debit slip is carried conveniently on the right of the ledger and entry of each debit posting to the ledger is made *from the ledger* to the slip. When all journal debit postings have been made, the reverse posting slip is totaled and must agree with the total of the journal debit column for the items posted. Similarly, the journal credits are posted, reverse posted, and proved. The debit postings must equal the credit postings and thus proof is secured of the equilibrium of the ledger. Each journal is posted, reverse posted, and proved in a similar way. The bookkeeper is, in this way, sure of the correctness of his

work day by day. Oftentimes monthly recapitulations of these reverse posting slips are made and preserved as part of the business records. It will be seen that this method is identical with the ledger analysis method explained above but applied at the time of making the posting instead of at the close of the period.

Check Figures in Posting

The use of the check figures 9 and 11 in the verification of the arithmetic processes of addition, subtraction, multiplication, and division was referred to earlier. Other odd numbers, such as 13, 17, and 19, are less frequently employed. The number 11 gives perhaps the most satisfactory results from the standpoints of ease of application and accuracy of results. Its use in the verification of postings is somewhat as follows:

An additional column similar to the folio column should be provided in all the books for the check numbers. As an amount is posted to the ledger the bookkeeper should determine the check number from the item as it is written in the ledger—not from the journal item—and enter it in the check column in both ledger and journal. When postings from the journal are complete, the journal is totaled and the check figure for its sum found. If this agrees with the sum of the check figure column in the journal, posting is presumably correct. If the two items do not agree, the check number for each amount in the journal debit column should be proved. Inasmuch as the check number used was obtained from the ledger amount, a wrong check number for the journal amount would indicate a wrong posting which should now be turned to and corrected. The check numbers in the ledger accounts are used only for verifying account totals and balances and may even be carried into the trial balance for proving it. Practice in the use of any check number

soon develops accuracy and speed and makes the method easy of application and commendable wherever the work must be proven day by day as completed.

Errors in Columnar Books and Controlling Accounts

These are frequent sources of trouble unless handled with care. In the chapter on columnar books, it was laid down as a basic principle that *all* items appearing in the general amount column should be entered in some analysis column, i.e., analysis columns should be provided for distribution of *all* items. This makes proof of distribution possible and establishes formal equilibrium of the book so that errors in posting are not so likely to occur.

Care must be exercised in posting the discount columns of the cash book to the proper sides of the respective accounts.

In the use of controlling accounts, where a special column is not provided, as for Accounts Receivable on the credit side of the cash book, posting of the item should be made both to the individual account and also to the controlling account.

Trial Balance Adjustment Account

Where error creeps into the ledger and seems impossible of detection at a monthly trial balance period, the device of forcing a balance is sometimes used by setting up an account called "Trial Balance Adjustment," "Error in Trial Balance," or other similar title. To this is charged or credited the amount of the difference in the trial balance. It is a temporary makeshift, a method of holding the item in suspense until the error is located. Needless to say, the inclusion of such an account does not improve the appearance of a trial balance, but may be countenanced as a temporary expedient.

Practice Data*

(Assignment for Chapter LIV)

Close the ledger, through the journal, taking account of the following adjustments and inventories:

Accrued Expenses—salesmen's salaries $250; general salaries $342.75; unpaid bills on buildings repairs $436.20; in-freight $314.75; mortgage interest $50; interest on note held by Mechanics Hardware Co. $4.92, and one held by American Hardware Supply Co. $10.

Prepaid Expenses—advertising $983.50; insurance $2,501.67; general expense $129.60; discount on company's $5,000 note $44.17.

Accrued Income—interest earned on the following notes: Salzer $17.36; Colonial Supply $4.76; Hoffman $3.67, and Mishkin $2.38.

Take account of depreciation at yearly rates of:

2% on buildings.
15% on delivery equipment.
10% on all furniture and fixtures.

Set aside 2% of the outstanding accounts and notes receivable as a reserve for doubtful accounts.

Inventories on hand at the store and warehouses are:

Department A, $41,276.20.
Department B, $43,987.56.

Take into consideration Department B goods out on consignment. Charge 80% of the insurance cost to trading. Apportion in-freight between the two departments on the basis of purchases. Declare a 10% dividend to be paid on December 15 and carry the balance of the profit and loss to Surplus.

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*See Practice Data for Chapter LII.

CHAPTER LV

SINGLE OR SIMPLE ENTRY

Different Systems or Bookkeeping

Someone writing of the various systems of bookkeeping facetiously makes a three-fold classification, viz., (1) No Entry, (2) Single Entry, and (3) Double Entry. Esquerré in his "Applied Theory of Accounts" gives brief explanation of two other systems, Logismography and Statmography, based respectively on a triple and quadruple entry method. It is the purpose of this chapter to treat only of single or simple entry, differentiating it broadly from double entry. From the classification given above, it may be inferred that single entry is not far removed from the "no entry" system; in fact, some writers and accountants say that single entry cannot be classed as a system. A system should presumably be systematic, but there are degrees of system. With that limitation single entry may be called a system. Under certain conditions, however, it serves the desired purpose and provides the information absolutely needed. An early writer defines bookkeeping as "the art of recording mercantile transactions in a regular and systematic manner." In further elucidation he says, "A merchant's books should contain every particular which relates to the affairs of the owner. They should exhibit the state of all the branches of his business; the connection of the various parts; the amount and success of the whole. They should be so full and so well arranged as to afford a ready information in every point for which they may be con-

sulted." Single entry hardly measures up to these requirements, but nevertheless it has its place and while it is not recommended as a system there are places and circumstances where it does well. As brought out in an early chapter, bookkeeping had a development contemporaneous with industrial life. Only simple records were needed so long as that life was simple, but with its increasing complexity, previous methods became inadequate.

Single Entry

Single entry may be defined as that method of keeping records which sorts out and classifies debits and credits only as they apply to persons, the proprietor included, and usually cash. To justify the strict application of the term system, it must needs keep record of *all* transactions. Methods—not systems—of single-entry account-keeping are sometimes met with which do not make full record. Of them it may be said that they are retrograding towards the "no entry" method, rather than being examples of a single-entry *system*. The point of view of single entry is personal. All features of the business not connected with persons are looked upon as being under the direct hand of the owner, and subject to his control. But uncompleted transactions with persons, whether customers or creditors, are not capable of such oversight without the aid of individual, classified records. The necessity of safeguarding the cash and keeping its flow under review makes the classified cash record an almost universal feature of single entry. As a usual thing, therefore, single entry is characterized by: (1) a record of all transactions; (2) a debit and credit analysis only as applicable to persons and to cash; and (3) a classified and grouped record, i.e., ledger record, only as to persons and cash. It does not analyze every transaction in its relation to the business as a whole. It has a single point

of view, i.e., it considers only persons and cash and makes entries accordingly. Hence, its name.

Books Required and Methods of Record—The Journal

In a single-entry system, three books of account are necessary—the journal, the cash book, and the ledger. The cash book records all cash transactions, receipts and payments, classified as to persons but otherwise in narrative form. The journal records all other transactions following the same method. The ledger makes secondary record only under the heads of customers, creditors, and proprietor. The journal is the standard two-column journal, the first column being used as an "items" column, the second for totals. A three-column journal is advantageous, the first column being used for items and for all unposted amounts, the second for debit postings, and the third for credit postings. This aids in proving the ledger postings, as will be seen later. Transactions affecting persons are recorded under that person's name followed by "Dr." or "Cr." according to analysis of the transaction. This is necessary since position does not show it, the single-entry journal not using the method of left and right position for debit and credit. All other transactions are recorded in narrative form, i.e., merely a memorandum is made of them.

Cash Book

The cash book is the same as for double entry, receipts on the left and disbursements on the right-hand page or column, according as a double or single page cash book is used. Where the double page is used, one of the two columns on either side is sometimes used for the exclusive extension of the amounts to be posted to personal accounts. This facilitates posting, since these are the only amounts which are to be transferred to the ledger.

Ledger

The single-entry ledger is the same as the double-entry and uses the debit and credit principle of the double-entry. As stated above, accounts are kept only with persons, including the proprietor. It is seen, therefore, that single-entry books make a record of *all* transactions but fail to analyze those transactions in their relations to one another and in their effects upon the business.

Single Entry as Adapted to Modern Needs

Recognizing the value of the analysis secured by double entry but overestimating the work required to make the record, some concerns have developed single-entry systems through use of subsidiary records and columnar books, from which they derive very full information for management purposes. A sales journal gives volume of sales, a purchase journal shows the amount of goods purchased, and analytic columns in the cash book show the main sources of receipts and their amounts and the main classes of expenses and their amounts. A bill book is used for recording notes receivable and payable, and inventory books for scheduling all kinds of property, assets and liabilities. All of these make a system approaching the double entry in completeness of detailed information, but one which lacks the fundamental principle on which the double entry rests, viz., an equality of debits and credits brought about by a classified analysis of every transaction into its debit and credit elements at time of first entry on the books. It lacks the tying together of the whole into a mathematically provable system. Since the advent of double entry there have always been strong adherents to the single-entry method. An early writer, William Perry, in 1777 presents a treatise on bookkeeping by either method. Most small enterprises, even if they keep their records by the single entry method in the beginning, usually

adopt the double-entry system as their business increases, realizing that the latter furnishes better accounting control than is obtainable under simple entry.

Debits and Credits

To one who knows the method of double entry, single-entry bookkeeping presents few or no difficulties. Debit and credit as applied to personal accounts are usually of easy determination and are exactly the same as in double entry. The debits and credits for cash are based on the same principles in both methods. The method of writing them in the books of original entry was sufficiently indicated above where those books were explained. Posting is done just as in double entry. With regard to all work upon single-entry books, there is always a temptation to do slovenly, inaccurate work because the system does not provide internal proof as does the double-entry system. Thus, where rebates have been allowed, only the net amount received may be shown in the cash book with explanation that the payment was in full of account. After this amount is posted to the customer's account, the item does not fully offset the original debit and it is necessary to make a note in the ledger to the effect that the item is fully settled. The same thing holds true for creditors' accounts. Of course. this is not good bookkeeping whether practiced in single or double entry.

The Proprietor's Account

The handling of the proprietor's account is very similar to that under double entry. The proprietor's capital account shows the original investment on the credit side; his personal account, if kept separately, is debited with his withdrawals, whether in merchandise or cash. Inasmuch as the single-entry ledger does not show the profit or loss, the

manner of handling the proprietor's account at closing is somewhat different. The profit, as determined by the method shown a little later, may be brought directly and without journal entry from the statement of profit and loss into the proprietor's capital account, so that this account will show the true net worth of the business as at that time. The personal account is simply ruled off after its figures have been used in determining profit. Efforts have been made to work out a method whereby the proprietor's account will show all current changes in net worth so that at the end of the fiscal year no adjustment will need be made. To accomplish this the profit or loss from any transaction must be recorded in the proprietor's account at the same time the transaction itself is recorded. While this can be done, there is never the certainty of correctness, and the analysis and work necessary to accomplish it are out of all proportion to the value of the results obtained. These results are much easier of accomplishment by other means.

Proof of Posting

The only proof of work possible under single entry is a checking of the secondary record against the original. A trial balance of the ledger cannot be taken. A schedule or list of account balances may be prepared and debit and credit totals of the list made. This compared with a similar list prepared at the close of the last period will show the changes taking place this period. A list of the debits and credits to personal accounts in books of original entry for this period must check against the net change shown by the above comparison. Virtually this amounts to a second posting of the items and, if the two postings agree, the presumption is that the ledger is correct. The use of the "personal" posting column for the cash book as explained above, and of similar columns in sales and purchasing journals, makes

possible a much easier debit and credit summary of the books of original entry, if some proof of posting is desired.

Profit and Loss

Inasmuch as many of the factors affecting the net worth have not been analyzed in making the original entry, no detailed showing of profit and loss, as understood under double entry, can be made. It is, of course, possible to go back over the books and make such an analysis, but this would result practically in rewriting the books on a double-entry basis. Single entry, therefore, has recourse to another method which is characterized by a complete inventory-taking and appraisal. It is sometimes called the asset and liability method as explained in the following section.

Inventory and Appraisal

A physical inventory or count of all assets, fixed, current, and deferred, is made. The books furnish only the accounts receivable and the cash. All other assets are usually made up by physical count and re-appraisal. It is consequently very easy to lose sight of some assets, particularly in the case of additions and betterments to existing assets. For the deferred items, the inventory of supplies on hand supplemented by the proprietor's memory is the customary source.

Liabilities

Liabilities are more difficult of correct determination. The accounts payable are shown on the ledger, the notes payable should be shown in the bill book or by stubs in the bound blank book of notes. Any unpaid bills may be found in the current file of unpaid invoices if one is maintained and the bill has been received. For all others and for deferred income the memory must serve. The haphazard manner in which this statement must be made up is therefore apparent.

Accrued and Deferred Items

There is usually little or no notice taken of accruals and deferred items on account of the difficulty in securing trustworthy and full information. The theory of averages, viz., that one period's items of that sort will offset, in the long run, those of another period, is the theory by which the failure to include accruals and deferred data is excused. A comparison of this method with the double-entry method for handling similar items throws into strong relief the inaccuracy of the single-entry method, under which it is almost impossible to obtain correct results.

The Balance Sheet and the Determination of Profit

The statement of financial condition, listing all assets and all liabilities, makes a determination of proprietorship or net worth possible. The financial statement, by the inventory and appraisal method, must be taken periodically. A comparison of the net worths as shown by successive statements develops the gain or loss provided no other elements affecting net worth have become involved. The additional element to be taken into consideration is the relation of the proprietor to the funds of the business. He may have withdrawn some of the assets or he may have made additional investments, so that the condition of the assets as shown at the end of the period is not entirely the result of business activities and transactions. Profits determination by this method, therefore, must take cognizance of the two factors —(1) comparative net worths, and (2) proprietor's interim drawings and investments. A withdrawal of cash during the period equal in amount to the profits for that period would result in the same net worth at the close as at the opening of the period. Drawings in excess of profits would cause a less net worth at the end than at the beginning; and less withdrawals than profits would cause an increased net

worth. But under none of the three cases stated would a comparison of the two net worths show the actual profits.

Similarly, additional investments have an opposite effect, bringing about an increase in closing net worth in the exact amount of the additional investment and so obscuring the true amount of profit or loss for the period. Accordingly, the increase or decrease of net worth as shown by the comparative statements of financial condition must be adjusted in accordance with the proprietor's withdrawals and additional investments to make a correct determination of profits. To the change in net worth—treated algebraically, i.e., positive if an increase and negative if a decrease—must be added the withdrawals, and from this sum the additional investments must be subtracted in order to determine the profits for the period.

In the next chapter will be given illustration of some of the points and methods discussed here.

Practice Data*

(*Assignment for Chapter LV*)

Draw up pro forma balance sheet and statement of profit and loss for the year ending November 30, 1916. Show the gross profit on both kinds of sales. Support both the balance sheet and the profit and loss statement with properly set-up schedules.

*See Practice Data for Chapter LIV.

CHAPTER LVI

ILLUSTRATION OF SINGLE ENTRY

Single and Double Entry Compared

From the points discussed in the previous chapter and the illustrations which follow in this chapter it will be seen that single entry can be worked through to a conclusion as to profit and loss. It tells nothing of the sources of that profit or loss, nor does it give any control over expenses. It is true that a comparative statement of assets and liabilities as shown in Chapter V, showing the increases and decreases of the various assets and liabilities, will give more information, but even that does not show the reasons for the change, and so affords no basis for control. For such purposes, the statistical totals of the sales and purchase records and the cash book, where analytical columns are used, furnish the only information available under single entry. Its only advantage, then, is brevity, the saving of labor in making the record. No difficult analysis is met with in the original record and posting is much less in amount than with double entry. But brevity and labor-saving are secured at the expense of the very information which the business man needs. The advantages of double entry may be summarized as follows:

1. The ledger shows a classified record of every transaction.
2. Expenditures for capital purposes, i.e., for new assets or additions and betterments to existing assets, are recorded as such and so there is no danger of losing sight of them.

3. A gross profit figure is obtainable and percentages of profits and expenses, making possible an *estimate* of merchandise inventory at any time. This is particularly valuable in case of fire loss.
4. The double-entry method provides a proof of the mathematical accuracy of the ledger.
5. A full statement of sources of profits and causes of expenses can be obtained in double entry.

Where the above advantages and information are not desired nor necessary, as in a very simple business under the immediate supervision of the proprietor, or in simple executorship transactions, etc., single entry may suffice.

Opening Entries

Upon opening a set of books to be kept by single entry as complete a record should be made as under double entry. If the proprietor begins business with an investment of cash only, without assuming any obligations, an entry in the cash book of the amount invested as a credit to the proprietor's capital account is all that is necessary. If the investment transaction is more complex, other properties being brought in, liabilities assumed, and obligations as to lease, salaries, etc., being undertaken, a very careful and complete record should be made in the journal showing the kinds and values of all properties invested, and also the kinds and amounts of all the liabilities assumed. This is best arranged in schedule or statement form with extension into the posting money columns only of those personal items for which accounts are to be opened in the ledger. Illustration will be given of a simple set by single entry, using journal, cash book, sales and purchase records, and ledger. A separate statement or diary of the transactions will be given covering in summarized form a six months' period so that the entries may be traced.

Problem. June 30, 1916, A. B. Cornell purchased a store and business, paying therefor $7,750. He took over the following assets and liabilities at the values shown: store building and lot $3,000; furniture and fixtures $500; horse and wagon $250; accounts receivable, B. C. Davis $50, C. D. Elliot $75, D. E. Foley $100, E. F. Gaynor $25, F. G. Harvey $125; stock of merchandise $5,250; mortgage on real estate $500; accounts payable, G. H. Jackson & Co. $250, H. J. Kelsey $375, J. K. Landon Co. $500. He deposited $500 as an aditional investment. During the six months the following transactions took place: cash sales $10,000; sales on account, Davis $300, Elliot $400, Foley $500, Gaynor $600, Harvey $700; purchases were, cash $1,500, Jackson & Co. $500, Kelsey $450, Landon $750, Morey & Co. $1,000. He returned goods to Morey & Co. $50, received an allowance from Kelsey $20. He made Harvey a rebate of $25. He received cash on account from Davis $250, Elliot $300, Foley $400 and notes from Gaynor $250 and Harvey $500. He paid on account cash to Morey & Co. $500, Jackson & Co. $600, Kelsey $675, a note to Landon $1,000; he paid off the mortgage with interest $530; expenses paid were, clerks $750, cashier, stenographer, etc., $250, N. Y. C. Ry. for freight $250, horse feed and expense of driver $125, newspaper and street car advertising $300. Cornell drew $2,000, and made an additional investment of a safe valued at $250.

At the close of the year inventories and appraisals of data not on the ledger showed as follows: store building and lot $2,970; furniture and fixtures $725; horse and wagon $235; merchandise $3,000; notes receivable $750, with accrued interest of $2.50; notes payable $1,000, with accrued interest $15; accrued salaries and expenses $25. It is decided to value the accounts receivable at face value less 2%.

JOURNAL

Date				L. F.	Items	Dr.	Cr.
1916 June 30	A. B. Cornell commenced business purchasing the store and stock of the .... Company, taking over all its assets and assuming all its liabilities and obligations. He deposited $500 as a working fund for the business. The following shows his investment assets and obligations:						
	Assets						
	Store Bldg. & Lot		$3,000.00				
	Furniture & Fixtures		500.00				
	Horse & Wagon		250.00				
	Merchandise		5,250.00				
	Accounts Receivable:						
	B. C. Davis ....Dr.	$50.00		5		$50.00	
	C. D. Elliot ....Dr.	75.00		5		75.00	
	D. E. Foley ....Dr.	100.00		5		100.00	
	E. F. Gaynor ....Dr.	25.00		5		25.00	
	F. G. Harvey ....Dr.	125.00	375.00	5		125.00	
	Cash		500.00				
	Total Assets				$9,875.00		

Liabilities

	Mortgage on Real Estate		$500.00				
	Accounts Payable:						
	G. H. Jackson & Co. Cr.	$250.00		5			$250.00
	H. J. Kelsey Cr.	375.00		5			375.00
	J. K. Landon Co. Cr.	500.00	1,125.00	5			500.00
	Total Liabilities				1,625.00		
	A. B. Cornell, Capital Cr.			6	$8,250.00		8,250.00
Dec. 31	Morey & Co. Dr.			5		50.00	
	Returned goods as unsatisfactory.						
	H. J. Kelsey Dr.			5		20.00	
	Allowance a/c inferior goods.						
	F. G. Harvey Cr.			5			25.00
	Rebate a/c dissatisfaction.						
	E. F. Gaynor Cr.			5			250.00
	Note at 3 mo. 6% on a/c.						
	F. G. Harvey Cr.			5			500.00
	Note at 60 da., no interest on a/c.						
	J. K. Landon Co. Dr.			5		1,000.00	
	Note at 6 mo. 6% on a/c.						
	A. B. Cornell, Capital Cr.			6			250.00
	Made additional investment of office safe.						
						$1,445.00	$10,400.00

JOURNAL

Date					L. F.	Items	Dr.	Cr.
1916								
Dec. 31	Financial Statement							
	Assets							
	Store Bldg. & Lot			$2,970.00				
	Furniture & Fixtures			725.00				
	Horse & Wagon			235.00				
	Merchandise			3,000.00				
	Accounts Receivable:							
	B. C. Davis	$100.00						
	C. D. Eliot	175.00						
	D. E. Foley	200.00						
	E. F. Gaynor	375.00						
	F. G. Harvey	300.00	$1,150.00					
	Less, Bad Debts estimate		23.00	1,127.00				
	Notes Receivable			750.00				
	Accrued Interest on above			2.50				
	Cash			1,970.00				
	Total Assets					$10,779.50		

Liabilities

Notes Payable	$1,000.00				
Accrued Interest on above	15.00				
Accrued Salaries and Expenses	25.00				
Total Liabilities			1,040.00		
Net Worth			$9,739.50		
A. B. Cornell, Capital 6/30	$8,250.00				
Additional Investment	250.00				
	$8,500.00				
Drawings	2,000.00				
	$6,500.00				
Net profit this period	3,239.50		9,739.50		
A. B. Cornell, Personal ... Cr.		6			$3,239.50
To carry the net profit to Cornell's Personal account.					
A. B. Cornell, Personal ... Dr.		6		$1,239.50	
A. B. Cornell, Capital ... Cr.		6			1,239.50
To transfer the balance of profit left in the business to Cornell's Capital account.					
Totals				$1,239.50	$4,479.00

Sales Journal

1916 Dec. 31	Cash			$10,000.00
	B. C. Davis	5	$300.00	
	C. D. Elliot	5	400.00	
	D. E. Foley	5	500.00	
	E. F. Gaynor	5	600.00	
	F. G. Harvey	5	700.00	
	Sales on Account		$2,500.00	
	Sales for Cash		10,000.00	$10,000.00
	Total Sales		$12,500.00	

Purchase Journal

1916 Dec. 31	Cash			$3,500.00
	G. H. Jackson & Co.	5	$500.00	
	H. J. Kelsey	5	450.00	
	J. K. Landon Co.	5	750.00	
	Morey & Co.	5	1,000.00	
	Purchases on Account		$2,700.00	
	Purchases for Cash		3,500.00	$3,500.00
	Total Purchases		$6,200.00	

Dr.		Cash					Cash			Cr.
1916					1916					
June 30	A. B. Cornell........	√		$500.00	Dec. 31	Purchases			$3,500.00
Dec. 31	Sales			10,000.00		Morey & Co. on a/c..	5	$500.00	500.00
	B. C. Davis on a/c..	5	$250.00	250.00		Jackson & Co. " ..	5	600.00	600.00
	C. D. Elliot " ..	5	300.00	300.00		H. J. Kelsey Co. " ..	5	675.00	675.00
	D. E. Foley " ..	5	400.00	400.00		Mortgage & Interest.			530.00
						Clerks			750.00
						Cashier, Stenographer			250.00
						N. Y. C. Ry. Freight.			250.00
						Horse Feed & Driver Expense			125.00
						Newspaper Advertising			300.00
						A. B. Cornell.......	6	2,000.00	2,000.00
						Balance			1,970.00
			$950.00	$11,450.00				$3,775.00	$11,450.00
1917									
Jan. 2	Balance			$1,970.00					

B. C. Davis

1916			1916		
June 30	J2	$50.00	Dec. 31	C4	$250.00
Dec. 31	S4	300.00			

C. D. Elliot

1916			1916		
June 30	J2	$75.00	Dec. 31	C4	$300.00
Dec. 31	S4	400.00			

D. E. Foley

1916			1916		
June 30	J2	$100.00	Dec. 31	C4	$400.00
Dec. 31	S4	500.00			

E. F. Gaynor

1916			1916		
June 30	J2	$25.00	Dec. 31	J2	$250.00
Dec. 31	S4	600.00			

F. G. Harvey

1916			1916		
June 30	J2	$125.00	Dec. 31	J2	$25.00
Dec. 31	S4	700.00	" "	"	500.00

G. H. Jackson & Co.

1916			1916		
Dec. 31	C4	$600.00	June 30	J2	$250.00
			Dec. 31	P4	500.00

H. J. Kelsey

1916			1916		
Dec. 31	J2	$20.00	June 30	J2	$375.00
" "	C4	675.00	Dec. 31	P4	450.00

J. K. Landon Co.

1916			1916		
Dec. 31	J3	$1,000.00	June 30	J3	$500.00
			Dec. 31	P4	750.00

Morey & Co.

1916			1916		
Dec. 31	J2	$50.00	Dec. 31	P4	$1,000.00
" "	C4	500.00			

A. B. Cornell, Personal

1916			1916		
Dec. 31	C4	$2,000.00	Dec. 31	J3	$3,239.50
" "	J3	1,239.50			

A. B. Cornell, Capital

			1916		
Net Worth			June 30	J2	$8,250.00
(down)		$9,739.50	Dec. 31	J3	250.00
			" "	J3	1,239.50
		$9,739.50			$9,739.50
			1917		
			Jan. 1		$9,739.50

Ledger List (Before Closing)

B. C. Davis	$100.00	
C. D. Elliot	175.00	
D. E. Foley	200.00	
E. F. Gaynor	375.00	
F. G. Harvey	300.00	
G. H. Jackson & Co.		$150.00
H. J. Kelsey		130.00
J. K. Landon Co.		250.00
Morey & Co.		450.00

A. B. Cornell, Personal	2,000.00	
A. B. Cornell, Capital		8,500.00
	$3,150.00	$9,480.00
		3,150.00
Excess of credits		$6,330.00

PROOF

Total postings from Journal	$1,445.00	$10,400.00
" " " Sales Journal	2,500.00	
" " " Purchase Journal		2,700.00
" " " Cash Book	3,775.00	950.00
	$7,720.00	$14,050.00
		7,720.00
Excess of credits as above		$6,330.00

Net Profits

Inasmuch as the change in proprietorship is determined only by a comparison of the two financial statements, at least the result of the comparison should be incorporated into a journal entry and so reach the ledger account. Sometimes the statement itself and the calculation of change in net worth are made on the face of the journal, thus making permanent record of them. This is worth while since they are an essential part of the system. A permanent statement book would accomplish the same result. In the illustration the statement is entered in the journal. The net profit of $3,239.50 may be set up in the proprietor's personal account, and the balance of that account, being the amount of profits retained in the business, transferred to the capital account; or the net amount left in the business may be transferred directly to the capital account and the personal account ruled off without balancing as suggested in Chapter LV. The same result is accomplished, but the ability to prove postings against the books of original

entry is lost. Hence the first method which is the one shown in the illustration is the better.

Change from Single to Double Entry

If it is desired to change from single to double entry, all that is necessary is a complete inventory and appraisal, to be used as the basis for an opening journal entry, debit and credit, as for any opening entry. If the former single-entry ledger is to be used, only the items not already posted, i.e., the impersonal items, will be posted from this opening entry. The proprietor's account should first be adjusted to its correct figure by a determination of profits by the single-entry method. If this is done, no posting to his account is needed from the opening entry for the double-entry books. This opening entry posted will bring the ledger into equilibrium and that will be maintained under the double-entry method. If a new ledger is to be used, the opening entry above referred to will be posted completely, personal and impersonal items, which will, of course, bring about the equilibrium desired. Thereafter all transactions will be analyzed and entered according to the double-entry system.

Problems

(Assignment for Chapter LVI)

1. What single rate of discount is equivalent to the series 20%, 20%, and 20%? 50%, 10%, and 5%?

2. February 1, 1917, the bank rendered statement of account of Jackson-Richter, showing a balance subject to check of $3,950.26. Jackson-Richter's cash book showed $4,690.38. In reconciling, the following information is secured. Jackson-Richter checks outstanding were, No. 219 for $125, No. 230 for $75.20, No. 201 for $19.18, No. 241 for $605.73, No. 236 for $5.25, No. 225 for $21.40, and No. 217 for $6.30;

checks on out-of-town banks deposited for collection and credit but not yet credited, Utica $598.18, Syracuse $720.50, Buffalo $279.50. Prepare a reconciliation statement.

3. Upon establishing an "Accounts Receivable" controlling account on the general ledger the total of customers' balances was $21,492.17. At the close of the month the cash book showed receipts from customers of $25,487.50; the bill book total was $5,250.40, all of which except a note for $500 was received from customers; the sales book total was $39,420.17, of which $5,280.65 was cash and $327.50 were proprietor's withdrawals; the sales returns and allowances journal totaled $1,219.75. Set up the general ledger Accounts Receivable account and show all postings to it.

4. In a manufacturing concern the total value of buildings and equipment subject to insurance was $155,000, distributed as follows: Department 1, $25,000; Department 2, $45,000; Department 3, $35,000; Department 4, $10,000; Power House, $40,000. The annual insurance premium amounted to $3,105. The rates on Departments 1, 2, and 3 were the same; on Department 4 the rate was double that on Department 1, and on the power house 2½ times that on Department 1. Find the amount of insurance burden chargeable to each department and the power house.

5. On July 1, 1917 a trader's stock of goods was destroyed by fire but he saved his books of record. His goods were fully insured and he proved his loss from the following facts: value of goods on hand January 1, 1917, $21,500; purchases from January 1, 1917 to July 1, 1917, $54,300; sales from January 1 to July 1, $63,750. His records for the past three years showed an average gross profit of 20% on sales. Find the value of the stock destroyed by fire.

6. On December 4 you received a consignment of goods for sale on account of Jas. Scoville & Co., showing an invoice value of $2,150. You paid freight and cartage of $50.25. Sales were made on December 10 $750, and December 21 $1,025.75, on a 5% commission basis. On December 31, upon closing your books, you inventory the balance of the unsold consigned goods at $537.50. Show your treatment of the above, when closing.

CHAPTER LVII

SOME PHASES OF INTEREST

The Nature of Interest

Interest may be defined as the charge made for the use of money. Sprague defines it as the increase in principal due to the lapse of time. This definition brings out the essential element of time, but is practically the same as the ordinary definition. The ethics of the practice of charging interest was questioned by the ancient world and not fully conceded as right until modern times. Various economic theories have been evolved to arrive at the true character of interest. Whatever may be the theories on which it rests, interest as a commercial phenomenon is thoroughly established and countenanced by the law, although in many states an exorbitant interest charge is classed as usury.

Commercial Interest

Commercial interest, so called, usually contains an element in addition to the time-charge for the use of money. That element may be: (1) in the nature of an insurance against loss of the money loaned, i.e., the risk taken in making the loan or; (2) where capital in some fixed form is loaned, an allowance or additional charge to cover the shrinkage in the asset loaned due to wear and tear.

Simple and Compound Interest

As to its method of calculation, interest may be simple or compound. Simple or single interest is figured on the single base known as the principal, the only other element being the length of time. Compound interest periodically

adds the unpaid interest to the previous principal, and so secures interest not only on the original principal but on all unpaid interests as well.

In accounting both kinds of interest are recorded under the common title interest, and the business man is happy to secure its collection under any title. Some applications of the interest principle to certain special accounts will be discussed.

Equation of Payments

The practice of averaging accounts is occasionally, though not often, met with at the present time in American business. In proceedings in bankruptcy, all claims against the bankrupt on open or running account comprising several items, when filed with the trustee, must show the average due date of the items if it is expected to secure interest on the overdue amounts.

The problem involved may best be seen by an example. The following account appears on A's books, showing charges against B:

B

Jan. 5	Mdse. 2/10, n/30.	$100.00		
Feb. 1	Mdse. 2/10, n/60.	350.00		
Apr. 10	Mdse. net.......	200.00		
June 2	Mdse. 2/10, n/60.	2,000.00		

If B does not settle the various amounts as they come due, A is deprived of the use of his money longer than contemplated in the sale contract. In justice to him, interest on the overdue amounts ought to be allowed. If B should pay any of the amounts earlier than the terms of sale require, he should be allowed a discount, i.e., a rebate equal to the interest for the time of prepayment. It may be further that

B shortly after the last purchase on June 2 at 60 days, amounting to \$2,000, will desire to settle the entire account, taking his discount for prepayment on the \$2,000 and allowing A interest on the overdue amounts. If the date of settlement is fixed, the amount necessary to settle equitably may be determined by the method used for the account current in the previous chapter.

Average Due Date

But B may want to know the date on which he can settle equitably by paying the exact amount of the account without either paying interest on the overdue items or taking discount on the \$2,000. The problem involved is that of averaging or equating accounts; the equated date, due date, or average date of payment are the terms variously applied to the date of equitable settlement. If the account has only debits or only credits, equation is called simple or single equation or average; if it has both debits and credits, equation is called compound or double.

In order to determine the equated date, an arbitrary date, called the focal date, is taken for the purpose of computing the interest charges and credits, and from that date interest is counted backwards or forwards according to the result arrived at through use of the arbitrary date. Interest is calculated at an arbitrary rate, usually 6% (100% per day is used by another method of calculation), and, in the case of compound equation, the same rate must be used on both debits and credits.

To illustrate the method of calculation for simple equation and the interest principle involved, the above cited account will be equated. In order that the expired time between the focal date and each date of value may be easily computed, the last day of the previous year is taken as the focal date. Interest is at 6%.

Date of Entry	Date of Value	Expired Time	Amount	Int. on Total Amount for 1 Day	Interest on Each Amount for Expired Time
1/5	2/4	35 da.	$100		$.58
2/1	4/2	92 "	350		5.37
4/10	4/10	100 "	200		3.33
6/2	8/1	213 "	2,000		71.00
			$2,650	.44 1/6	)$80.28
					182 da.

The above calculation shows that, theoretically, had the various transactions been under contemplation on December 31, the focal date, payment of the total $2,650 could equitably have been made with a discount of $80.28. The interest (or discount) on $2,650 for 1 day is 44 1/6c. A discount amounting to $80.28 could therefore be demanded on $2,650 only as the result of an offer to prepay 182 days ($80.28 ÷ .44 1/6 = 182) before equitably due. Hence, payment of $2,650 without discount would settle the account equitably 182 days after the focal date, or July 1. That this is true can easily be proven by using July 1 as the settlement date and figuring as for a current account. It will be found that interest on the overdue items on that date amounts to $10.42, while the discount on the item not yet due amounts to $10.33; the difference .09 not being a large enough fraction (9 ÷ 44 1/6) to justify payment one full day earlier.

The 100% Method

A short method of calculation may be used, employing the 100% per day method. Any date may be taken as a focal date, and very frequently the date of the first or last transaction is used. In the illustration below, November 30 of the previous year is taken as the focal date so that the expired time on each item is immediately indicated by the *number* of the month and the day in the

"date of value" column. The use of the 100% rate method makes the calculation of interest on each item a simple matter of multiplication by time and amount, i.e., it reduces each amount to a "day-dollars" figure, and on that basis one day's interest on the account total is equal to that total, and, therefore, the divisor in the division to determine the focal date is the amount of the account. This greatly simplifies all the operations. Sometimes the expired time is calculated by calendar months and days, converting fractions of a month on a 30-day basis. The method is used in the illustration below, where the problem shown above by the accurate interest method is solved by the 100% method.

The "month-dollars" column divided by the "amount" column gives 6, shown in the "equated date, months" column, with a remainder of 2,500. This is reduced, by multiplication by 30, to day-dollars and carried to that column, whose total, 80,100, is divided by 2,650, giving 30 as shown in the "equated date," days column. The equated date is therefore June 30 (6/30). The one day's difference between this and the other method is accounted for because each calendar month is counted as 30 days.

Time Months	Time Days	Amount	Month-Dollars	Day-Dollars	Equated Date Months	Equated Date Days
2	4	$100	$200	$400		
4	2	350	1,400	700		
4	10	200	800	2,000		
8	1	2,000	16,000	2,000		
		2,650	)18,400	5,100	6	30
			15,900			
			2,500			
			30	75,000	June	30
				80,100		
				79,500		
				600		

Compound Equation

Where the account has both debits and credits, the estimate is made similarly. Calculation of the month- and day-dollars is made for each side separately. At this point the totals on both sides are combined to find the balance of the account and the balance of the discounts, and these two balances are used to find the equated date. If the balance of the account is on the same side as the balance of the discount, the equated date is forward from the focal date because, if settlement were made on that date, the man who owes the balance is entitled to the theoretical discount also. If the balance of the account and the balance of interest are on different sides, the count is backward from the focal date. The following account and solution will illustrate:

S. L. Davis

1917			1917		
Mar. 8	Mdse. net.....	$1,000.00	Apr. 30	Note, 30 da., 6%	$500.00
June 20	" n/30....	1,500.00	Aug. 30	Cash	1,500.00
Sept. 5	" n/60....	2,000.00	Sept. 10	Note, 60 da., no int.	2,000.00

Debits:

Expired Months	Time Days	Amount		Interest Month-Dollars		Day-Dollars	
3	8	$1,000		$3,000		$8,000	
7	20	1,500		10,500		30,000	
11	4	2,000		22,000		8,000	
	Totals		$4,500		$35,500		$46,000

Credits:

4	30	$500		$2,000		$15,000	
8	30	1,500		12,000		45,000	
11	9	2,000		22,000		18,000	
			4,000		36,000		78,000

Balances:

Amount	Dr. $500		
Interest		Cr. $500	Cr. $32,000

Dividing we get 1 month, 64 days, i.e., 3 months, 4 days. The balances being on opposite sides, the equated date is 3 months, 4 days, backwards from November 30 (11/30), i.e., 11/30 — 3/4 = 8/26 or August 26. Equitable settlement could therefore be made by interest-bearing note for $500, date August 26, 1916, or by cash payment of $500 plus interest on $500 for 3 months, 4 days, as would be the case had the account been handled as an account current with adjustment as of August 26, 1916.

The Cash Balance

When an account has been equated, to determine what cash sum would be required for equitable settlement on a given date subsequent to the equated date, the balance of the account plus interest on that balance from the equated date to the date of settlement will be the correct amount. This amount is technically called the Cash Balance of the account. It is exactly the same as the adjusted balance of an account current, and may be determined that way instead of by the equation of payments method above.

Interest on Partial Payments

Under the heads of accounts current and equation of payments, the question of partial payments on open account has been treated. There remains a statement of the practices governing partial payments on notes. Two methods of calculating are in use, the legal or United States method and the so-called merchants' method. The merchants' method is used for short time notes and on any other kind by agreement. The method is exactly similar to that of adjustment of current accounts. Interest is charged on the face of the note from its date of issue till its due date, and allowed on each partial payment from its date of payment till the due date of the note.

United States Rule

The United States Supreme Court has ordered the application of the partial payments somewhat differently. The first partial payment must first be applied to the payment of the accrued interest on the principal up to the date of the first payment. Any excess shall be applied to a reduction of the principal. Each succeeding payment is similarly applied first to cancellation of accrued interest on each new principal and then to a reduction of the principal. In case any payment is insufficient to meet the accrued interest, the payment is held in reserve, the principal remaining unchanged until a payment or payments are made which added to the previously reserved payment or payments are sufficient to cancel all accrued interests to that date. Any excess is used as above.

Interest on Daily and Savings Bank Balances

In the handling of balances between banks, interest on daily balances is usually figured in the settlement. Calculation is on a 365-day basis in the larger banks. Banks frequently allow to large depositors a low rate of interest on daily balances maintained above a certain fixed minimum. Take the following account:

X. Z. & Co.

Date	Dr.	Cr.	Balance	Interest Base	Interest
Jan. 2			1,500	500	
3	300	500	1,700	700	
4	800	100	1,000	....	
5	400	600	1,200	200	
6	500	400	1,100	100	
7	700	1,100	1,500	500	.11
				2,000	

In the above account interest is allowed on all amounts above $1,000 at the rate of 2%. If settlement is periodi-

cal, interest may be calculated on the total of the "Interest Base" column for one day. Usually, however, if on a monthly settlement basis, the total minimum balance for the month is subtracted from the total of the "Balance" column, the remainder is the interest base. In savings banks no interest is allowed on amounts which have been withdrawn during an interest period, regardless of how long the sum may have been on deposit previous to date of withdrawal. There is no uniform practice as to when deposits shall begin to draw interest, in some banks at the beginning of the month after deposit, unless deposit is made on the first day of the current month; in others, no interest is allowed till the beginning of the next interest period. Great care must be exercised, therefore, in handling deposit and withdrawal dates.

Bank and True Discount

Bank discount has been defined as the prepaid or collected interest on a discounted note, calculation being on the basis of the amount to be collected on the note at its maturity.

True discount is the difference between the face of a debt and its present worth, meaning by present worth that sum of money which placed at interest now will equal or be worth the face of the debt at maturity.

Problems

(Assignment for Chapter LVII)

1. Jackson and Edson had on June 30, 1916 the following assets and liabilities: cash $1,000; notes receivable $2,500; unexpired insurance $150; notes payable $3,150; interest unpaid $125; merchandise on hand $15,800; accounts receivable $20,500; coal $50; office supplies $25; furni-

ture and fixtures $375; delivery equipment $1,100; accounts payable $8,225. Of the net worth 2/3 belonged to Jackson and 1/3 to Edson. Keeping their accounts by single entry and dividing profit and loss on the 2 to 1 basis referred to above, they find their condition at the end of fiscal year: cash $2,500; notes receivable $3,000 on which was accrued interest of $25; unexpired insurance $225; merchandise $12,490; accounts receivable $18,175; coal $140; office supplies $10; furniture and fixtures $510; delivery equipment $1,275; building $5,000 on which was a mortgage for $3,000; notes payable $4,250 with accrued interest of $50; accounts payable $8,550; and salaries unpaid but earned $150. During the year Jackson had made an additional investment of $2,500 and Edson of $1,250; Jackson had withdrawn $7,500 and Edson $4,000.

Determine the net profit or loss for the period and set up the partners' accounts showing their present worth at the close of the year.

2. Equate the following account and find the cash balance due August 1, 1917, money being worth 4½%:

F. T. Frederick

1917			1917		
May 4	Merchandise 60 da.	$1,360.00	May 14	Cash	$360.00
				Returned Merchandise	150.00
14	Merchandise 30 da.	720.00	June 10	Cash	800.00
26	Merchandise 60 da.	1,080.00	21	Note, 20 da....	750.00

3. A note for $1,500 dated June 20, 1916, bearing interest at 5%, had payments indorsed as follows: December 5, 1916, $300; April 2, 1917, $10; July 20, 1917, $500; December 31, 1917, $400. Find the amount due June 22, 1918. (U. S. rule.)

APPENDIX A

REVIEW QUESTIONS

The following questions will enable the student to review briefly the essential theory presented in this volume.

Chapter I

1. Give a brief account of record-keeping among the Ancients.
2. Among the Romans.
3. Among the early English.
4. Give a brief description of Italian double-entry bookkeeping.
5. Discuss the development of the ledger account.
6. Give a brief account of organized accountancy.

Chapter II

1. In what way, and why, is accounting so closely related to economics? To law?
2. What is the basic problem of accounting?
3. Define assets and liabilities.
4. Define proprietorship. State the two customary forms of the proprietorship equation.
5. Illustrate the usual method of setting up the equation.
6. How would you define financial statement or balance sheet?

Chapter III

1. What are the three types of business organization?
2. State the characteristics of the single proprietorship.
3. What are its disadvantages?
4. Define a partnership and state its essential working characteristics.
5. What advantages has the partnership over the single proprietorship?
6. Name some disadvantages of the partnership.
7. State several characteristics of the corporation.
8. Discuss its working organization.
9. Carefully distinguish between the methods of showing proprietorship under these three types.

Chapter IV

1. What is the purpose of the financial statement?
2. To what uses may it be put?
3. What are current assets? Fixed assets? Current liabilities? Fixed liabilities?
4. What is the reason for subdividing the assets and liabilities into the above groups?
5. Give alternative titles for financial statement, assets, and proprietorship.
6. What should the formal heading of a financial statement include?
7. State the principles governing the amount of detail to be shown in the statement.
8. Explain briefly: reserve for depreciation of building; reserve for bad debts; prepaid expense; accrued expense.
9. How are the items mentioned in Question 8 shown in the financial statement?

Chapter V

1. What is the purpose of a comparison of net worths at certain periods?
2. Does it give a basis for judging effort by results?
3. What purpose does a detailed comparison of individual assets and liabilities serve?
4. What four different relationships between the assets and liabilities may develop a profit?
5. What additional factors must be taken into account to make sure that the results shown by Question 4 are correct?
6. State the conditions of the assets and liabilities which with the restriction of Question 5 will show a loss.
7. Illustrate the form of the comparative financial statement.
8. Does such a statement show the cause or the manner of the change in proprietorship?

Chapter VI

1. Show the advantage of having fuller information than that furnished by the comparative financial statement.
2. What information, in addition to that used previously, must the accounting department furnish?
3. From what two points of view must the record of every business transaction be made?
4. Under what heads is this additional information furnished?
5. Why are these records called temporary proprietorship records?
6. Develop the logic of the profit and loss summary, using your own data.

Chapter VII

1. By what other titles is the profit and loss summary shown?
2. What do you understand by a fiscal period? What is its customary length?
3. Why is it necessary to take a physical inventory of stock at the close of the fiscal period? What purpose does this accomplish?
4. State the principles governing the make-up of the profit and loss statement.
5. What are the main sections of its content?
6. Give the reasons for the order and arrangement of its content.
7. State the algebraic equations governing its content.
8. What disposition is made of the net profit?
9. What is the appropriation section?
10. State at least two advantages in being able to determine "net profit" by two means.
11. What additional information is sometimes given?

Chapter VIII

1. In what various aspects may the temporary proprietorship records of a business be viewed?
2. What relationship is there between expenses and assets and liabilities?
3. What relationship exists between income and assets and liabilities?
4. May assets and liabilities change among themselves without affecting the economic elements?

Chapter IX

1. Define the ledger account.
2. What principles govern the selection of the account title?
3. Describe the two sections of the account, as to title, the various columns and their use.
4. How are the items sorted in the account as to addition and subtraction?
5. What is the ledger? What is its purpose in account-keeping?
6. What two main classes of accounts are kept in the ledger?
7. What principle governs the number of accounts to be carried in the ledger?

Chapter X

1. What are meant by: (a) an account in balance; (b) the balance of an account?
2. Discuss the balance of the account as related to assets, liabilities, expenses, income.

3. Explain fully the business transaction from the standpoint of the record to be made of it.
4. State the origin of the terms "debit" and "credit" and indicate their present use.
5. Explain the basic principles of debit and credit in their relation to the various classes of accounts.

Chapter XI

1. What can you say of the effort to reduce debit and credit to one fundamental working rule?
2. What relation does the proprietorship equation bear to debit and credit?
3. How is the placing, as to their debit and credit, of the various account groups determined? Give the philosophy underlying.
4. Since the original investment is reducible to the fundamental equation, how should all later transactions be viewed?
5. State the schedule used for the determination of debit and credit.
6. Give at least one illustration in each group of the use of the schedule.
7. Explain the constant equilibrium of the ledger.

Chapter XII

1. Give the debit and credit schedule for customers' accounts.
2. For accounts with creditors.
3. Illustrate the application of the schedule for media of exchange in the case of: (a) cash, (b) notes receivable, and (c) notes payable.
4. Explain the meaning of the term "full cost" as used in the schedule for fixed assets.
5. How is the sale of a fixed asset recorded?
6. Explain the debit and credit of other liability accounts.

Chapter XIII

1. Define proprietorship accounts.
2. Distinguish between temporary and vested proprietorship accounts.
3. What explanation of relationship among the four groups of accounts would be required in order that *one* fundamental rule for debit and credit may be formulated.
4. Why, under the scheme of debit and credit used here, are income items credits and expenses debits?
5. Give and illustrate the schedule for income items.
6. Give and illustrate the schedule for expense items.
7. Explain fully "vested" proprietorship accounts.
8. State their debit and credit rule.
9. Illustrate the kinds of transactions frequently recorded under the two heads.

Chapter XIV

1. Discuss the impracticability of separating a sale into its elements of cost and profit.
2. What is the objection to the old Merchandise account ?
3. Give its schedule.
4. Give the modern practice in showing merchandise transactions and state its advantages.
5. What do you understand by a mixed account?
6. Distinguish between the terms "inventory" and "appraisal."
7. Why, at the close of a fiscal period, are accounts with assets subject to depreciation, mixed accounts?
8. Illustrate, and explain the reasons for, the handling of depreciation.
9. What are valuation, offset, and adjunct accounts?
10. Why is it important to discriminate between capital and revenue expenditures?

Chapter XV

1. What is the trial balance? What is its use?
2. Explain fully the work on the ledger preliminary to taking the trial balance.
3. Illustrate the balancing of an account.
4. Explain the various rulings in an account.
5. Explain the different methods of transferring an account.
6. What is meant by summarizing the ledger?
7. What class of accounts is summarized? What accounts are left open?
8. Explain the method of rulings and entries in personal and note accounts.
9. Explain the use of the index number or letter in personal and note accounts.

Chapter XVI

1. Why, at the close of a fiscal period, does the current record of the ledger need adjustment?
2. In what particulars is the current record lacking?
3. Explain fully the manner of adjusting the merchandise record: (a) when kept under detailed accounts; (b) when kept in one account.
4. Distinguish between adjusting and closing the merchandise record.
5. Explain and illustrate the manner of bringing the appraised values of fixed assets onto the books.
6. Distinguish carefully between the depreciation account and the depreciation reserve account.

7. Explain and illustrate the handling of deferred expenses.
8. " " " " " " accrued expenses.
9. " " " " " " accrued income.
10. " " " " " " deferred income.

Chapter XVII

1. Why is the ledger record of business transactions insufficient and inconvenient?
2. What do you understand by a book of original or first entry?
3. In what respect is the ledger a secondary record?
4. Explain the entire process of posting.
5. Define the journal.
6. Name the essential characteristics of the journal.
7. Define a compound journal entry.
8. Draw the standard form of the journal and illustrate entry therein.
9. Distinguish between expense supplies and expenses.

Chapter XVIII

1. Show how the old journal is a labor-maker and consequently inadequate for present needs.
2. Explain the principle of the subsidiary journal and state its method of operation.
3. What is the basis of subdivision of the old journal?
4. Name the customary subdivisions.

Chapter XIX

1. State the content of the purchase journal.
2. Analyze a purchase transaction into its debit and credit elements and show the *classes* of accounts affected.
3. What is the problem of the cash purchase?
4. In what different ways may the cash purchase be handled?
5. Explain fully the posting and summarizing of the purchase journal.
6. Draw a form for the standard purchase journal and illustrate entry therein.
7. Illustrate the manner of securing a departmental analysis of purchases.
8. How is Purchase Discount closed at the end of the fiscal period?
9. What is the order of closing the expense accounts into Profit and Loss?

Chapter XX

1. What kind of transactions is recorded in the sales journal?
2. What is the form of the sales journal? Illustrate.

3. Analyze a sales transaction and indicate the manner of recording it.
4. How are cash sales recorded?
5. Explain the summarization and posting of the sales journal.
6. Discuss the problem of goods sold to the owner.
7. What is a post-closing trial balance? For what purpose is it used?
8. What is the basis for estimating percentages of profit and expenses?

Chapter XXI

1. Explain the way in which the two cash journals are usually bound together.
2. Analyze a cash receipt and indicate the manner of record.
3. Analyze a cash disbursement and indicate the manner of record.
4. Draw a form for the standard cash book and illustrate entry in it on both sides.
5. How and why may the cash book take the place of the ledger account with cash?
6. Explain the posting of the cash book.
7. What is the effect of omitting the cash account from the ledger?
8. Explain the balancing and ruling of the cash book.
9. What is the purpose of the Cash Short and Over account? Explain its use.
10. How is analysis secured as to the sources of receipts and the objects of expenditures?
11. Analyze a cash discount transaction as to its debit and credit elements.
12. Explain three methods of booking cash discounts.
13. Discuss the advantages and disadvantages of the methods.

Chapter XXII

1. What general principle governs or determines the content of the general journal?
2. Name the kinds of transactions recorded here.
3. Discuss the question as to explanations required for the journal entry.
4. Why does not the journal need summarizing at the close of the period?
5. Explain the analytic journal.
6. Illustrate and explain opening entries.
7. Illustrate and explain adjusting and closing entries.
8. What objection is there to the direct method of closing the ledger?

Chapter XXIII

1. What is meant by business papers? How are they used?
2. Give the essentials of the goods invoice.

3. Explain a method of handling the purchase invoice.
4. Explain a method of handling the sales invoice.
5. Explain the use of the sales ticket under the folder system.
6. What is the returned goods invoice? Explain its use.

Chapter XXIV

1. Explain the use of the note receivable.
2. Define negotiable instruments. Name the various kinds.
3. Explain the use of the draft and give the entries on the books of the various parties, at the time: (a) of drawing the draft, (b) of acceptance, (c) of payment.
4. Classify drafts on three different bases.
5. Define the various kinds of checks.
6. Explain some other kinds of negotiable instruments.
7. What principle governs the writing of commercial paper?
8. Define the various kinds of indorsements.

Chapter XXV

1. What is the bill of lading? How is it usually made out? What use is made of the various copies?
2. What is the freight or expense bill?
3. Explain the C. O. D. transaction through the medium of: (a) the express company; (b) the bank and the railway company.
4. Explain the statement of account.

Chapter XXVI

1. What are the functions of the bank?
2. How is an account opened with the bank? How are deposits made? What is the use of the pass-book?
3. Explain the various ways of keeping the bank account on the check book.
4. Explain the process of discounting a note.
5. State the principles to be observed in interest calculations.

Chapter XXVII

1. When should the books of original entry be posted?
2. Give the method of posting the various journals.
3. When should the entry be cross-indexed?
4. What explanatory matter should be carried in the ledger?

Chapter XXVIII

1. State the various methods of taking the trial balance and discuss them

2. What are uniphase accounts?
3. To what use is the trial balance put? What kinds of errors does it fail to detect?
4. Give several methods of detecting errors.
5. What are transpositions? How may they be detected?
6. What are transplacements? How may they be detected?

Chapter XXIX

1. State the principles governing the taking of the inventory.
2. How is the inventory valued? How can it be falsified?
3. Explain the manner of making the journal entries for: (a) the inventory; (b) depreciation; (c) bad debts; (d) prepaid expense; (e) deferred income; (f) accrued expense; (g) accrued income.
4. What is the objection to erasures? How should corrections be made on the books?

Chapter XXX

1. What is the purpose of summarizing the books?
2. Explain fully the entire process of closing the books.
3. Should the Profit and Loss account be used for current entry? Why?
4. Differentiate between the financial statement and the balance sheet.
5. Give the two forms of the statement of profit and loss. State advantages and disadvantages.
6. How may the profit and loss statement be used as a guide in closing the books?

Chapter XXXI

1. What is the purpose of account classification?
2. Distinguish between personal and impersonal accounts.
3. What other classifications are there? Distinguish between them.
4. What are the requirements for a good classification?
5. State and illustrate the effect of a wrong classification.
6. What is meant by detailed analysis and classification? Illustrate.

Chapter XXXII

1. How does Pixley divide the field of accountancy?
2. Define analysis. Define synthesis.
3. Illustrate the manner in which the accountant makes use of these two processes.
4. What danger is there in a too detailed subdivision of accounts?
5. In what way is the ledger analytic? In what way is it synthetic?
6. What two forms of standard-ruled ledger do we have? Illustrate.
7. What forms are there for the balance ledger? Illustrate.

8. What is a progressive or tabular ledger? Illustrate.
9. What are some of the advantages of loose-leaf and card ledgers?
10. What objections can be made to them?
11. In what order should the accounts be arranged in the ledger?
12. What is a classified trial balance?

Chapter XXXIII

1. What is a partnership?
2. Name some advantages of the partnership over the sole proprietorship.
3. Discuss the management organization of the partnership and its legal status.
4. Explain fully the limited life and liability characteristics.
5. What is meant by co-ownership of profits as profits?
6. What is the purpose of articles of copartnership?
7. What should they contain?
8. Name two standard classifications of partnerships.
9. Give the requirements in New York for the formation of a limited partnership.
10. What is a joint-stock company? Its chief features?
11. Classify partners.

Chapter XXXIV

1. What should the articles of copartnership contain with regard to division of profits?
2. Where no basis for division is stated, what basis does the law supply?
3. Are both profits and losses shared in the same ratio?
4. Where the profit-sharing ratio is equal to the capital ratio, what is the effect of partners' profits left in the business?
5. What should be the provision with regard to partners' drawings?
6. When profits are shared on the basis of capital and the length of time of its employment, how are the shares determined?
7. Under what conditions or in what kind of undertaking is the profit-sharing basis of Question 6 met with?
8. What is the purpose of allowing interest on partners' capitals?
9. Because interest is allowed on capitals, is it necessary also to allow interest on drawings?
10. Where the investment of a partner comprises property, what is the effect of an under- or over-valuation of it at time of investment?
11. Distinguish between buying an interest in a partnership as it stands and making an investment in a business to secure an interest in it.

12. Why should the partners have periodic statements of condition drawn up and formally accepted by signature of each?

Chapter XXXV

1. What fundamental principle governs the handling of cash?
2. How is this principle applied?
3. What is the need of a petty cash fund?
4. Discuss two methods of handling petty cash.
5. How is the distribution of petty cash disbursements made?
6. Explain several methods of keeping the bank account.
7. Where, in the cash book, the net cash column is at the same time used as a bank column, how should spoiled checks be handled?
8. Describe the method of handling checks exchanged for currency.
9. Describe the method of handling checks given for "change."
10. Where branches are maintained, how should you account for working funds turned over to them?

Chapter XXXVI

1. Name and define the different classes of discounts.
2. Accountancy makes record of which kinds?
3. What advantages does trade discount secure?
4. Explain the method of calculating a single rate equivalent to a given discount series.
5. What two chief factors enter into cash discount?
6. Explain fully the relation each of these factors bears to the discount rate offered.
7. What other factors may sometimes enter in?
8. In the profit and loss statement how should cash discounts be shown?
9. Explain and illustrate several methods of entering cash discounts.
10. Explain the handling of cash discount where it enters into the finding of the cash balance.
11. Discuss and illustrate a method by which the information as to neglected discounts may best be secured.
12. Explain the effect of trade acceptances on the practice of cash discounts.

Chapter XXXVII

1. Under what title should the account with negotiable instruments be carried?
2. Discuss the legal relation of notes to open personal accounts.
3. Discuss their relative liquidity.
4. What data should enter into the record of a note?

5. Explain the standard note or bill journal.
6. Explain the note register with special reference to due date and the method of summarizing it for posting.
7. Does the entering of notes at their face value ever result in an inflation of the assets?
8. Illustrate the entering of a note on the books when interest is included in the face of the note.

Chapter XXXVIII

1. How are credits shown in the Notes Receivable account, when the debits are itemized?
2. What is meant by contingent liability under discounted or transferred notes and drafts?
3. What is the best method of recording the discounting of a note receivable?
4. What is the balance sheet status of the Notes Receivable Discounted account?
5. Theoretically, how should the transfer of notes and the issuing of drafts be recorded?
6. Explain the steps necessary to protest a note.
7. What is the proper accounting procedure for a note dishonored in your hands?
8. What, when the dishonored note has been discounted by you at the bank?
9. How should notes receivable out as collateral be handled?
10. Why distinguish between customers' notes and others?
11. How would you distinguish between customers' notes and others in entering them on the books?
12. What accounting problem is involved in the renewal of notes and in partial payments on notes?

Chapter XXXIX

1. Give a classification for business activities.
2. What is the importance of the "selling end" of a business?
3. What purposes are served by an analysis or classification of sales?
4. How is distribution secured in books of original entry on a chronological basis? How on any other basis?
5. What proof of distribution should always be provided for?
6. Describe a method whereby the sales ticket is used for sales analysis.
7. Where an analysis of the sales is made, how should purchases, returned sales, and returned purchases be handled? State the reasons.
8. How does an analysis of sales affect the ledger records?

9. Explain one method of handling cash sales in a ledger account where analysis of sales by departments is desired.
10. What is the problem involved in recording sales to branches?
11. In recording consignment sales?
12. In recording instalment sales?
13. In recording sales for future delivery?
14. In recording department store sales?
15. How are C. O. D. sales handled?
16. Describe fully the bill and charge system.
17. How are salesmen's commissions and efficiency records handled?

Chapter XL

1. In what different ways may the capital of a partnership be increased?
2. When partners fail to live up to their agreements with regard to the amount of capital to be contributed, how may their interests be equitably adjusted?
3. In special partnerships of a temporary nature where capital contributions are not fixed, what method of adjusting partners' interests is frequently used?
4. Where partners leave some portion of their profits in the business, how should the profit and loss ratios be adjusted?
5. Why should additional contributions be recorded differently from loans made by partners?
6. Distinguish between the borrowing of funds for the purpose of increasing (a) fixed capital and (b) current capital.

Chapter XLI

1. Is there any difference between purchasing a share of the profits and a share of the net assets?
2. On what three bases may a new partner be admitted?
3. Give the entry showing admission on the first basis.
4. On the second basis.
5. On the third basis.
6. What is good-will? What condition as to earnings is the essential basis of good-will?
7. When may good-will be shown on the books?
8. On what basis is good-will distributed among the partners?
9. What accounting problem is encountered in partnership consolidations?
10. What is the relation of partners' loans to the credit of the firm?

Chapter XLII

1. State the meaning of the term "profits."
2. What elements are included in the profits of a partnership?

3. For the purpose of comparisons between periods, what should be the method of showing the profit and loss?
4. How may extraordinary profits and losses be cleared?
5. What is the purpose of partners' salaries? How are they treated in Profit and Loss?
6. What is the purpose of allowing interest on partners' capitals? On partners' drawings? How are they recorded on the books?
7. Explain the handling of interest on partners' loans.
8. What is the purpose of a reservation of net profits?
9. How should partners' salaries be handled when allowance of such salaries results in a net loss for the period?
10. How should partners' withdrawals and salaries be booked? How should partners' personal bills be handled?
11. At the time of a change in partnership, what is the importance of a careful determination of profits?

Chapter XLIII

1. State and illustrate the four classes of adjusting entries to be made before closing.
2. How should the following items be handled at inventory time?
   (a) Goods ordered but not yet received.
   (b) Goods received but not yet booked.
   (c) Goods held on consignment for account of a principal.
   (d) Goods out on consignment for sale by an agent.
   (e) Goods sold for future delivery.
3. Explain and illustrate two methods of handling an expense account when a portion of it is to be deferred.
4. What different accounts are used for summarizing the results of the period?
5. What is a Trading or Selling account? What is its content and its relation to the Profit and Loss account?
6. What is the relation of the balance sheet to the post-closing trial balance?
7. Outline and discuss a plan of arranging balance sheet items.
8. Explain fully the manner of using a working sheet.

Chapter XLIV

1. State various causes leading to the dissolution of a partnership.
2. Who should receive special notice of dissolution? What other notice is required?
3. Under what arrangement may a firm be continued after the death of a partner without the necessity of taking inventory at that time?

4. In what order must the net proceeds of the assets be applied in the liquidation of creditors' claims?
5. In what ratios are profits and losses and capital resulting from liquidation shared by the partners?
6. In what ratios are ultimate net assets shared?
7. In case of bankruptcy of one of the partners, how is his share of the losses borne by the other partners?
8. In case of liquidation, under what circumstances may a partner be liable to further contributions ?
9. What problem is involved in instalment payments to partners?
10. What two methods are employed for recording good-will upon the sale of a partnership? Illustrate.

Chapter XLV

1. What is the main purpose of subsidiary records and columnar books?
2. What is the basis for division of the ledger?
3. What are customary divisions?
4. Mention and describe four different types of sales journals.
5. Mention and describe three different types of purchase journals.
6. Explain two methods of handling expense invoices.
7. What analysis should be made in summarizing the note journal?
8. State and illustrate a standard columnization for the cash book.
9. What general principle governs columnization of journals?
10. State a standard columnization for the general journal.
11. How does the general journal differ in the manner of proof of distribution from other journals?

Chapter XLVI

1. Explain fully the debit and credit scheme of the various ledgers operating under a controlling account system.
2. How are the subsidiary ledgers proved? What is the importance of such proof?
3. What are the sources of postings to the sales ledger controlling account?
4. Explain the method of gathering the summary postings.
5. State the sources of postings to the purchase ledger controlling account.
6. Explain the method used for gathering the items in the various journals for summary posting to the controlling account.
7. Under a controlling account system, what fundamental requirements must be observed in posting items affecting both the controlling account and the subsidiary ledger?

8. What is a self-balancing ledger?
9. Explain fully the method of making the sales ledger self-balancing.
10. Discuss the advantages of the controlling account.

Chapter XLVII

1. Explain the method of opening the controlling account: (a) upon installation of a new system; (b) when introduced in an old system.
2. What general classes of items are recorded in the sales journal?
3. What is the effect of this upon securing the summary amount for posting to the controlling account?
4. How may these extraneous items be treated at summary time?
5. What extraneous items are recorded in the purchase journal?
6. How are they treated upon summarizing?
7. Explain fully two methods of treating accounts which are both receivable and payable.
8. How are the note journals summarized?
9. Illustrate a method of summarizing a columnar cash book to secure postings to controlling accounts and a ledger bank account.
10. What other controlling accounts are sometimes kept?
11. What principle governs the kind of accounts to be included in a subsidiary ledger?

Chapter XLVIII

1. Define a corporation. What are its chief characteristics?
2. Discuss its advantages.
3. Discuss its disadvantages.
4. Give briefly the entire process necessary to the formation of a corporation under the New York statute.
5. What is the corporation's charter?
6. What is the basis of the state's control over the corporation?
7. Explain fully the internal organization of the corporation.
8. How is the control of the stockholders exercised?
9. Under the corporate form, how is proprietorship shown?
10. What is the purpose of this required manner of showing?
11. Explain briefly the use of the records peculiar to a corporation.

Chapter XLIX

1. Distinguish between common and preferred stock.
2. Explain and illustrate four methods of opening the corporation's books.
3. Discuss the advantages and disadvantages of the various methods.
4. Illustrate the method of booking discount and premium on the sale of capital stock.

5. Explain the manner of accounting for payment of stock subscription in instalments.
6. Illustrate the method of opening the books when both common and preferred stock are issued.
7. Explain the method of booking payment of stock subscriptions by property.
8. Where a partnership is sold to a corporation, explain how the partnership books are closed.
9. What are a stockholder's rights as to profits?
10. What is the authority of the board of directors over profits?
11. Explain and illustrate two methods of closing the corporation's books, covering profits, reserve, surplus, declaration and payment of a dividend.
12. Is a dividend declared on the entire capital stock or only on that which has been issued and is now outstanding?

Chapter L

1. What is a consignment transaction? Name the parties to it.
2. How are the rules of bailment and principal and agent related to the consignment transaction?
3. Distinguish between broker, manufacturer's agent, and factor.
4. In general, what is the relation of the factor to his principal: (a) in the sale of goods—terms, title, collections, etc.; (b) in the safe-keeping of goods?
5. May the factor mingle his principal's property with his own or others?
6. What is the factor's lien? How may he exercise it?
7. What accounting is the factor required to make his principal?
8. What are the essentials of the account sales?
9. Give reasons for consignment trading.
10. Explain and illustrate two methods of recording the entire consignment transaction on the consignor's books.
11. Explain and illustrate two methods of recording the entire consignment transactions on the consignee's books.
12. At the end of the fiscal period how should the consignor handle unsold goods out on consignment? How should the consignee handle unsold goods held on consignment? How should the consignee handle commissions on partly sold goods?

Chapter LI

1. What are approval sales? Are they to be booked as sales?
2. Explain a method of handling them to secure correct results.
3. How should they be handled at inventory time?
4. What is the nature of adventure trading?

5. What is the nature of the joint venture organization?
6. What records are kept for the joint venture?
7. What is the source of entry on the records of the various partners?
8. Explain fully the booking of a joint venture transaction from opening to closing.
9. At a closing time how is the joint venture account handled if still incomplete?

Chapter LII

1. What is an account current?
2. What is its use at the present time?
3. What is an adjusted account current?
4. Illustrate a form for stating the account current with interest adjustments.
5. Illustrate two methods of showing the bank account reconciliation.
6. Where reconciliation is complex, state the heads under which analysis may be made in order to adjust.
7. Give examples of the four classes of items referred to in Question 6.
8. How are these four classes of items handled in reconciliation?

Chapter LIII

1. State the general principles for safeguarding the cash.
2. What is meant by internal check? Explain the method.
3. Illustrate a statement of receipts and disbursements.
4. Explain the problem involved in handling instalment sales.
5. How are such sales accounted for?
6. Explain the method of weighted proportion and its application to apportionments.
7. How are in-freight charges distributed over purchases and the inventory?
8. Explain the method of estimating inventories.
9. Under what condition are such estimates fairly accurate?
10. What is a condensed profit and loss statement? Illustrate.
11. Illustrate the method of showing gross profit by departments in the profit and loss statement.

Chapter LIV

1. State the only sure principle underlying the securing of a trial balance.
2. What is ledger analysis?
3. Explain the method of analyzing the ledger.
4. What purpose does ledger analysis serve?

5. Explain the slip or reverse posting system.
6. Explain the use of check figures in posting.
7. How should columnar books be proven?
8. Explain the use of the trial balance adjustment account.

Chapter LV

1. What is understood by single entry as a system?
2. What are the usual characteristics of single entry?
3. What are the fundamental records kept under single entry and how are they kept?
4. What analysis and information concerning the profits may be secured from books kept by single entry?
5. Explain the handling of the proprietor's accounts under single entry.
6. Explain a method of proving postings to a single-entry ledger.
7. What are the sources of the financial statement?
8. Explain fully the determination of profit and loss.
9. How do partners' drawings affect the determination of profits?
10. What formal record is made of the statement showing profits?

Chapter LVI

1. How are single-entry books opened?
2. Review carefully the problem worked out in the text.
3. Summarize the advantages of double entry.
4. Explain the method of changing from single to double entry.

Chapter LVII

1. Give briefly the theory of interest.
2. Explain briefly the theory of simple equation.
3. What is compound equation?
4. When is the method of averaging accounts applicable to present day practices?
5. What is the cash balance of an account?
6. Explain briefly the so-called commercial method of treating interest on partial payments on notes.
7. What is the United States Supreme Court rule?
8. Explain interest on daily bank balances.
9. What is the difference between bank and true discount?

APPENDIX B

PROBLEMS

The following problems and examples are inserted for the use of those who find it possible to cover more ground than that laid out in the practice work at the end of each chapter of the text. Through their use, it will also be possible to vary the assignments from year to year.

Consignments

1. On January 7, 1917, W, a fruit grower and dealer, consigns to Y, a New York commission merchant, 100 crates of berries, 40 boxes to the crate, at the same time drawing on consignee at sight for $100. The freight charges amount to $17.28. One-fourth of the goods is spoiled so as to be unsalable through the negligence of the R. R. Co., which pays $50 damages to Y in settlement. Of the remaining boxes, one-third are sold at 5 cents a box, and the balance at 10 cents a box, for cash, on January 10, the auction and commission charges being 5%. W's draft is paid by Y on January 8.

Prepare a statement to be sent January 20 by Y to W, with check in settlement of account to that date, interest being charged and allowed at the legal rate. Show the necessary accounts set up on Y's and W's books.

2. A ships B on consignment, under date of April 4, merchandise to the value of $1,500, paying $15 cartage and $6 insurance. B receives the consignment April 20, paying freight $70 and cartage $12. He subsequently disposes of the merchandise by sale as follows: April 30, $400; May 30, $800; June 30, $600; on which latter he pays storage charges, $30. He charges commission on sales 5%, credits net interest 6%, and transmits account sales with remittance of net proceeds to A, who receives them July 10.

Prepare shipment account as appearing on A's ledger, and consignment account as appearing on B's ledger.

Partnerships—Formation

3. A and B enter into partnership, A contributing $25,000, and B $20,000. Capital is to bear interest at 5% per annum. Profits are to be divided equally between the partners. The profits for the first two years (after charging interest on capital) were: $6,200 first year;

$7,400 second year; and the drawings of the partners (in excess of their salaries) were:

A, $1,500 first year; $1,750 second year
B, $1,200 first year; $1,500 second year

At the end of the second year C was admitted to partnership, and put into the business the same amount of capital as B had in the business at the time, and on the same conditions as to interest and division of profits. The profits of the business for the third year were $13,000, and the partners' drawings in excess of salary were:

A, $1,850
B, $1,700
C, $2,000

Set up the capital accounts of the partners for each of the three years, showing the balance of each at the end of the third year.

4. Two partners, named Wilson and Peters, find at the end of the first year's business the balance sheet shows that Wilson's interest is worth $18,000, and Peters' $9,000. The good-will of the firm is worth $3,000. Each draws profits in proportion to his investment. They conclude to take in a new partner and he is to have a one-quarter interest in the new firm.

What sum must the new partner contribute? How will the partnership accounts appear after the additional capital is paid in?

5. Aul and Bitt, each carrying on a similar business, agree to form a partnership, the new firm to take over the assets and assume the liabilities of each. The following trial balances, representing the book accounts of each were presented:

Aul

Capital		$ 40,000.00
Machinery and Fixtures	$ 30,000.00	
Cash	2,000.00	
Notes Receivable	4,000.00	
Accounts Receivable	30,000.00	
Inventory Merchandise	25,000.00	
Wages	7,000.00	
Wages Due		250.00
Expense	10,000.00	
Notes Payable		9,000.00
Merchandise		40,000.00
Accounts Payable		20,000.00
Repairs	1,250.00	
	$109,250.00	$109,250.00

BITT

Capital		$ 50,000.00
Machinery and Fixtures........................	$ 30,000.00	
Cash	4,000.00	
Notes Receivable............................	8,000.00	
Accounts Receivable..........................	40,000.00	
Wages	10,000.00	
Wages Due.....................................		500.00
General Expense..............................	15,000.00	
Notes Payable..................................		15,000.00
Merchandise		51,000.00
Inventory	32,000.00	
Repairs Account...............................	2,500.00	
Accounts Payable.............................		25,000.00
	$141,500.00	$141,500.00

Each partner is to draw one-half the profits. Formulate opening entries for the new firm.

At the end of the year a profit is made of $25,000. Divide the profit between the partners and show their capital accounts.

PARTNERSHIPS—CLOSING THE BOOKS

6. A, B, and C agree to start in business with a capital of $400,000, of which A is to furnish $200,000, B $100,000, and C $100,000. A is to have one-half share in the business, and B and C each one-quarter share; interest at the rate of 5% per annum is to be paid on excess capital if any. A contributes $200,000, B $90,000, and C $80,000.

How would the capital accounts stand on the books after adjusting the interest accounts at the end of the year?

7. A and B are partners, carrying on a business in Winnipeg. On January 1, 1917, after adding profit for the past one-half year, A's capital amounted to $150,000, and B's to $100,000. On that date they take into partnership C, upon the following terms: C is to bring in capital amounting to $25,000, and each partner is to be credited with interest on his capital 6% per annum. All profits (after debiting interest) up to $25,000 are to be shared by A and B exclusively in proportion to the amounts of their capitals at January 1, 1917. All profits in excess of $25,000 are to be shared equally by the three partners. Accounts are to be prepared and profits and interest credited half-yearly. C is to be credited with a salary of $5,000 per annum.

On June 30, 1917, the profits divisible after debiting C's salary, which he has drawn, but before charging interest on partners' capitals,

amounted to $75,000. The partners' withdrawals, which are not chargeable with interest, were: A, $12,500; B, $10,000; and C, $3,750. Draw up partners' accounts as they should stand on July 1, 1917.

Assume that instead of a profit, a loss of $75,000 has occurred. How would you have treated it in the accounts in the absence of any direct provision in the partnership agreement relative to losses?

Partnerships—Dissolution

8. A and B are partners in a wholesale dry goods business. A, the senior partner, agrees to retire, accepting for his interest $6,000 cash and four notes of $3,000 each, without interest, maturing at three-month intervals, commencing one year hence.

The following balance sheet is prepared prior to settlement of A's account:

A and B
Balance Sheet, December 31, 1916

Assets		*Liabilities and Capital*	
Cash	$10,000.00	Notes Payable	$10,000.00
Notes Receivable	11,000.00	Accounts Payable	16,500.00
Accts. Receivable	25,000.00	A Capital	16,900.00
Merchandise	11,000.00	B Capital	15,100.00
Fixtures	1,500.00		
	$58,500.00		$58,500.00

Show the entries on the books necessary to effect A's retirement.

9. X, Y, and Z were partners and contributed the following capital: X, $8,000; Y, $6,000; and Z, $4,000. Profits and losses were to be shared equally. At the end of the first year each partner had drawn $1,000. The assets were then disposed of for $3,000, the purchaser discharging all liabilities of the firm. Close the books of the partnership.

10. Wilson and Rainey are partners, sharing profits and losses equally. The partnership is dissolved December 31, 1916, at which time Wilson's capital investment is $10,000, and Rainey's $3,500. The total liabilities of the firm are $25,000, which include $5,000 due Wilson on loan account and $3,500 due Rainey on loan account. The whole of the assets of the firm are disposed of for $30,000 cash on May 1, 1917. Close the partnership books. No allowance for interest is to be made.

11. A partnership on equal terms between A and B is dissolved July 1, 1917, the books on that date showing the following:

A's capital paid in was $16,000, and his drawings were $3,500.

B's capital paid in was $2,000, and his drawings were $1,500.

Goods purchased $50,000; sales $40,000; business expenses $1,800. A loss of $1,600 was made on a $5,000 consignment of goods to Liverpool. In the settlement, A agrees to pay B an old debt of $3,500.

Prepare requisite accounts, and show final balance payable by one partner to the other.

12. A and B, partners in a mercantile business, share profits and losses equally. At the end of five years the partnership terminates by limitation, and the balance sheet shows the following:

Assets		*Liabilities*		
Plant and Machinery...	$15,400.00	Creditors		$30,000.00
Inventory	36,000.00	Bills Payable...........		10,000.00
Accounts Receivable....	28,000.00	Capital:		
Cash in Bank..........	5,600.00	A	$30,000	
		B	15,000	45,000.00
	$85,000.00			$85,000.00

Subsequently the business as it stands (except the cash in bank) is sold for $30,000.

Make final adjustments and closing entries, and show the amount each partner receives.

13. S and T began business August 1, 1916, S investing $8,000, T $5,000. Gains were to be shared equally and no interest was to be allowed on investments or charged on withdrawals. The firm was dissolved May 1, 1917.

The books had been kept in a haphazard fashion, but the partners agreed to the following statement which was submitted for settlement: net debit of S $2,100; net credit of T $3,500; cash on hand $3,400; 10 shares bank stock (market value $1,100); expense debit $3,000; credit $500. The bank holds the firm's note for $2,000, on which there is accrued interest of $60.

Prepare a statement showing the settlement of the partnership affairs.

Joint Venture

14. A, B & Co. agree with C, D & Co. that the latter shall ship on consignment to Honolulu on joint account 20 cases of commodity "X," the invoice price of which is $2,100, less 2½%. A, B & Co. pay the packing charges, $25; also freight, insurance, and other charges, $90, and

they draw on their correspondents in Honolulu in advance for $1,600 at 90 days, which is discounted at a cost of $20, and the proceeds handed to C, D & Co. as part payment. These transactions may be dated March 31.

On the 30th of November A, B & Co. receive the account sales and net proceeds, $418, and they then pay C, D & Co. the balance due them.

Prepare a joint consignment account, charging interest on the amount involved at 5% per annum for 8 months, closing it by dividing the loss; also an account to be rendered by A, B & Co. to C, D & Co., closed by payment of the balance and prove that the losses borne by each are equal.

15. On April 30, 1916, St. John & Co. and Carpel Bros. enter into a joint venture agreement. They each contribute $4,000 with which they pay for goods that are shipped on May 1 to John Doe, of San Francisco. St. John & Co. advance $400 to defray freight and incidental expenses. John Doe, the consignee, is allowed 10% on the cost of the goods, and is to sell them at whatever price he can obtain for them.

On June 1, 1917, on the strength of a report sent by wire, Carpel Bros. draw at sight on John Doe for $4,000 to the order of Carl Peter of New York. On July 1, 1917, St. John & Co. receive from the consignee a check for $11,200, all the goods being sold; on the same day St. John & Co. settle with Carpel Bros. Interest at 6% is allowed on all the transactions affecting the partners in the venture.

Prepare all the ledger accounts brought about by the above, on the books of St. John & Co., including a Joint Venture account. (Construct your ledger accounts in such a manner that they will explain fully what took place, and make a cross reference possible.)

16. Abbot and Ball are each conducting a separate business, but enter into a speculative partnership as a side line on January 1, 1916, to buy and sell aeroplanes. Purchases and sales are made sometimes by Abbot and sometimes by Ball, and each puts his transactions through his own business accounts, as no joint venture books are kept. They agree to divide profits and losses equally after allowing or charging interest at 6% on cash received or paid.

From the following information prepare statements due to each partner at the time of the dissolution of the partnership on December 31, 1916:

Jan. 1	Abbot buys for cash 2 aeroplanes at	$3,500
Jan. 1	Abbot pays expenses connected with above	150
Jan. 15	Ball " " " " "	100
June 1	Ball " " " " "	75
June 30	Ball sells for cash above aeroplanes at	4,100

July	1	Ball buys for cash five aeroplanes, each averaging......	2,500
July	31	Abbot pays expense connected with above..............	225
Aug.	31	" " " " " "	45
Sept.	1	Ball sells the five aeroplanes for......................	13,100
Sept.	1	Abbot buys one aeroplane for..........................	2,800
Sept.	15	Abbot sells the above aeroplane for....................	2,750

Compute interest on even half-months.

Corporations—Opening the Books

17. A firm whose resources and liabilities are stated below, is converted into a corporation:

Assets		*Liabilities*	
Real Estate and Improvements	$65,500.00	Accounts Payable.....	$8,800.00
Merchandise	16,000.00	Bills Payable..........	25,000.00
Accounts Receivable...	5,200.00	Partners' Accounts.....	55,000.00
Cash	2,100.00		
	$88,800.00		$88,800.00

The corporation receives all the assets except the cash, and assumes payment of the accounts payable but not of the bills payable. The real estate and improvements are taken over at a value of $100,000, and the good-will is to be considered.

The purchase price is to be as follows: $30,000 in cash, $50,000 in bonds, and $50,000 in capital stock of the company. $35,000 additional capital stock is sold at par for cash. Open the books of the corporation.

18. Thomas Jones and William Thompson are in partnership as wholesale grocery merchants, sharing profits equally. On January 1, 1916, their balance sheet is as follows:

Assets		*Liabilities*	
Stock in Trade.........	$27,245.00	Bank of B. N. A.......	$10,000.00
Furniture	2,752.00	Creditors	27,528.00
Debtors	37,625.00	Jones	25,243.00
Cash	752.00	Thompson	10,603.00
Good-Will	5,000.00		
	$73,374.00		$73,374.00

An agreement is made to amalgamate with Joseph Smith and George Brown, also trading in partnership and sharing profits respectively 2/3 and 1/3. Their balance sheet as on January 1 is as below:

Assets		*Liabilities*	
Stock in Trade.........	$35,424.00	Creditors	$35,818.00
Furniture	3,840.00	Smith	22,176.00
Debtors	42,741.00	Brown	27,426.00
Bank of Toronto.......	3,415.00		
	$85,420.00		$85,420.00

A company is formed to take over the business, under the name of Smith, Jones & Co., Ltd., with an authorized capital stock of $200,000, divided into 2,000 common shares of $100 each. George Wilkins, John Lister, and Robert Ryder subscribe for 20 shares each, for which they pay cash.

The Jones and Thompson business is taken over at book figures, except that good-will is raised to $10,000, and $1,000 is set up as a reserve for doubtful debts. The Smith and Brown business is taken as shown, with an addition of $15,000 for good-will and $1,500 reserve for doubtful debts. The partners in the two businesses are to take shares for their interests, making up an even amount by paying cash if required. All cash received is deposited in the Bank of British North America.

Show by journal entries the various transactions incident to taking over the business and allotment of shares, giving the number of shares allotted to each party, and make out the balance sheet of Smith, Jones & Co., Ltd.

19. The firm of Cottey & Dorset incorporates. From the following data make entries to effect the necessary changes in the accounts, the old set of books being used: Cottey's net capital, $8,768.97; Dorset's net capital, $6,741.86. Authorized capital stock of new organization, $20,000; par value of shares, $100. It is agreed that in exchange for their respective interests in the old concern, Cottey is to have 95 shares and Dorset 75 shares in the corporation, the balance of the capital stock to remain unissued for the present.

20. Wilson and Johnson, partners in a wholesale business, decide to incorporate. Their balance sheet shows assets and liabilities as follows:

Assets		*Liabilities*	
Cash	$2,250.00	Accounts Payable	$2,550.00
Merchandise	8,690.00	Mortgage Payable	5,700.00
Accounts Receivable	6,261.00	Salaries Accrued	105.00
Land & Buildings	8,500.00	Interest Accrued	280.00
Auto Truck	1,300.00	Wilson	9,816.75
Furniture & Fixtures	1,200.00	Johnson	9,967.25
Interest Prepaid	40.00		
Taxes Prepaid	178.00		
	$28,419.00		$28,419.00

Authorized capital stock of the new company is to be $25,000; par value of shares, $100. Wilson is to receive in exchange for his interest 119 shares in the new concern; Johnson receives 120 shares. The cash is not to be turned over to the corporation, but is to be divided between the parties in proportion to the number of shares of stock received by each. J. T. Jones and W. B. Smith purchase 5 shares each for cash.

It is decided that the old books are to be closed and a new set opened. Make the necessary journal entries to close out the old books and open the new set.

21. The Scott-Davis Company has been organized with an authorized capitalization of $500,000, all common stock, par value $100. The five incorporators subscribe for fifty shares each at face value.

J. W. Jackson purchases a business now being operated by Mack, Jacks & Bros., paying for the complete plant $475,000, and transfers the same to the newly incorporated company for the remaining common stock and $100,000 of first mortgage 5% bonds.

Make the opening journal entries.

22. The Interboro Company has been organized with a capital stock of $150,000, shares $100 each. There are three incorporators, J. Jacks, W. Wilson, and A. Anson, each of whom has subscribed for $20 000, of which one-half is paid in cash. They are to receive full-paid stock, and $30,000 is to be charged to organization expenses. The company has a franchise from the city of Jason giving it the right to use the streets for a tramway for twenty-five years.

The directors have placed on the market $50,000 of stock, which was immediately subscribed at 125, and one-half paid in, the balance to be paid in three instalments. Subscriptions have been received from I. M. Axman and W. S. Wright for 100 shares of stock each, at 150,

on which they have paid 75% in cash, the balance to be paid in one month.

The franchise cost $35,000. Of this amount $10,000 has been paid down, and $1,000 is to be paid at the end of each year.

Make the opening entries and post to the ledger, showing all the accounts involved. Show the accounts in the stock ledger also.

Corporations—Closing the Books

23. The X & Y Company has a capital stock of $750,000, one-third of which is 6% cumulative preferred stock. The company has also a surplus of $75,000, and bonds outstanding of $200,000 drawing 4½% interest, with ten years yet to run. The profits for the year are $51,550.25, out of which the directors have paid bond coupons, dividend on preferred stock, and 4% dividend on common stock. They have also added $5,100 to Surplus account, and $9,500 to Sinking Fund account.

Show all of the entries. Rule up all of the accounts involved and show how they will appear after carrying out the above instructions.

24. A corporation has outstanding $1,500,000 of full-paid stock. Its accumulated surplus is $250,000. The profits for the current year are $150,000. The directors declare a cash dividend of 6% and a stock dividend of 20%.

Make journal entries to record the dividend transactions.

25. The Arlington Manufacturing Co. was incorporated with an authorized capital stock of $100,000, of which $90,000 was subscribed for and $75,000 paid in. At the end of the fiscal period the net profit was $11,000. The board of directors declared a dividend of 10% on the subscribed stock, in proportion to amounts paid in, said dividends to be applied as part payment.

Make the necessary journal entries.

Corporations—Miscellaneous

26. A coal mining corporation proposes to issue bonds of the denomination of $1,000 each to the amount of $500,000 on January 1, 1917, bearing interest at 6% per annum, payable semiannually. Under the terms of the mortgage a fund equal to 10 cents per ton of coal shipped is to be set aside semiannually for the first three years, and at the rate of 12 cents per ton thereafter, the fund to be used as follows:

First, to pay the interest on the bonds.

Second—after paying interest the balance is to be used to redeem and cancel bonds at par, as of the dates on which the interest is paid; any balances remaining in the fund thereafter to be added to the fund of the next period. It is estimated that the tonnage will be 400,000 tons each six months for the first three years, and 500,000 tons each six months thereafter.

Prepare a tabular statement showing concisely the operation and the result of carrying out the proposed plan based on the foregoing estimates.

Single Entry

27. A. B. Trott and R. U. Shore, partners sharing equally in business, have determined to change their system of bookkeeping from purely single entry to double entry, continuing the use of the old ledger. The following statement shows the footings of the open accounts in their ledgers:

	Dr.	Cr.
A. B. Trott	$375.00	$5,000.00
R. U. Shore	1,250.00	6,000.00
A. M. Sanders	320.00	150.25
Martin Chevreaux	841.60	541.60
Hendry & Co.	482.50	2,200.00
E. R. Benson	500.00	640.00

The inventories are: merchandise, $6,500; Iron National Bank stock (10 shares) $1,000; cash on hand and in bank $4,124.82; bills receivable as per bill book $4,920.43; bills payable as per bill book $1,931.60.

Formulate a journal entry that, when posted, will change the ledger to double entry form, showing the items which will have to be posted. Give all the figures by which the result is obtained.

28. T. J. Slason and M. I. Howe are partners in business, sharing profits and losses in the ratio of 3:4. Their books have been kept by single entry, but they desire to change them to the double entry method. The following is an abstract of their affairs at this date:

Assets and liabilities as per ledger: T. J. Slason, investment $12,500; withdrawal $2,500; M. I. Howe, investment $12,500; withdrawal $2,000; sundry accounts receivable $8,500; sundry accounts payable $6,000.

Other assets and liabilities not in ledger: merchandise as per inventory $18,000; cash in bank $5,500; bills receivable $2,300; bills payable $2,000; bank stock $2,000; real estate $5,000.

Determine the amount of gain and loss of each partner at this date, and formulate proper journal entry for conversion of the former single entry ledger into a double entry ledger.

INVENTORY ADJUSTMENTS

29. In examining a business for the two years ending December 31, 1916, it is found that an item amounting to $750 had been omitted from the inventory of December 31, 1914; that an error had been made in the footing of the inventory of December 31, 1915, by which that inventory was overstated to the amount of $1,250; and that in pricing the inventory of December 31, 1916, an error was made by which that inventory was understated to the amount of $1,500. State fully the effect of these errors on the profit of each of the two years.

FIRE LOSS ADJUSTMENTS

30. A fire in the office of a firm of traders partly destroyed its books of account that had been fully posted in anticipation of proving their correctness. The following ledger accounts were found to be legible:

Purchases, net	$23,000.00
Cash discounts lost	320.00
Cash discounts gained	1,150.00
Sales, net	18,000.00
Bills receivable	11,000.00
Upon inquiry the bank balance was ascertained	43,000.00
Bills receivable had been discounted at the bank, amounting to	15,000.00
An inspection of the checks paid by the bank showed amount paid creditors, including $20,000 notes payable	33,000.00

A balance sheet prepared at the last closing of the books and containing the following items was produced by one of the partners:

Cash	$20,000.00	Accounts Payable	$10,000.00
Accounts Receivable	42,000.00	Notes Payable	20,000.00
Loans Receivable	8,000.00	Mortgages Payable	12,000.00
Real Estate	30,000.00	Capital	84,000.00
Notes Receivable	14,000.00		
Inventory	12,000.00		

The firm stated that the real estate, loans receivable, and mortgages payable remained as shown in the balance sheet. An inventory of goods in storage amounted to $15,000. With this information open a new set of books showing the position of the firm at the time of the fire.

31. The Ganver Garment Company, which was burned out on the night of September 16, filed with the insurance companies a claim for $95,436.70, which you are called in to verify or disprove.

You find the following balance sheet as of August 1, 1916:

Assets		*Liabilities*	
Cash	$9,224.67	Accounts Payable	$59,611.46
Accounts Receivable	88,669.43	Bills Payable	42,183.24
Bills Receivable	2,473.62	Capital Stock	50,000.00
Merchandise Inventory	42,618.97	Surplus	14,203.16
Machinery	20,419.04		
Furniture & Fixtures	2,000.00		
Prepaid Taxes & Insurance	592.13		
	$165,997.86		$165,997.86

At the close of business September 16, their ledger showed the following balances:

	Dr.	Cr.
Capital Stock		$50,000.00
Surplus		14,203.16
Cash	$5,418.22	
Accounts Receivable	118,871.14	
Notes Receivable	6,217.24	
Accounts Payable		72,898.66
Notes Payable		63,114.02
Machinery	21,619.34	
Furniture & Fixtures	2,147.30	
Inventory August 1, 1916	42,618.97	
Dividends	6,000.00	
Sales		162,917.31
Merchandise Purchases	103,430.22	
Labor	37,619.14	
Power, Light & Heat	3,716.47	
Factory Expense	7,119.11	
Office Salaries	2,250.00	
Office Expense	319.54	
Selling Expense	4,716.92	
Insurance	318.16	
Taxes	751.38	
	$363,133.15	$363,133.15

The company's gross profits on sales has been very uniform, averaging 20%, ever since the business was started. 10% for depreciation has been written off every year from Machinery and Furniture and Fixtures.

Insurance policies covering merchandise, machinery, and furniture and fixtures aggregate $100,000, and all contain the 80% coinsurance clause. The merchandise and furniture and fixtures were a total loss. The salvage in machinery is valued at $2,500, at which value the insured decided to retain it.

Prepare statement of claims against the insurance companies.

32. James Huitt and Willis Stivers are equal partners. On the night of July 3 their stock and fixtures were destroyed by fire.

A trial balance which Huitt had at his home, showed the following condition of the ledger at the close of business, June 30:

James Huitt	$600.00	$5,450.00
Willis Stivers	600.00	7,450.00
Cash	3,309.00	
Fixtures	1,500.00	
Merchandise Purchases	32,600.00	
Merchandise Sales		24,800.00
Notes Receivable	1,000.00	
Notes Payable		4,000.00
Interest	120.00	50.00
Expense	780.00	
Customers	4,500.00	
Creditors		3,259.00
	$45,009.00	$45,009.00

The property is fully covered by insurance. The insurance company, for purposes of estimating the value of the merchandise destroyed, has agreed to allow 35% as the average gross gain on the sales, and to pay 66 2/3% on the value of the fixtures as shown by the ledger. On the basis of this agreement, state the result of the business and the capital of each partner.

Notes, Drafts, etc.

33. X buys goods of Y on account for $2,500 and accepts Y's draft on himself for the amount. Y discounts the draft at a bank, the discount being $5. At maturity X cannot pay and the bank charges Y's account with the amount plus protest fees of $2.50. Later X pays Y the $2,500 and interest to the amount of $4.50 accrued since the original date of maturity and protest fees.

Show journal entry on Y's books and on X's books for the above transactions.

34. A owed B $1,000. B offered a discount of 2½% for cash. Not having the ready money, A discounted his note at the bank for sixty days at the rate of 6%, the note producing the sum required to discount B's claim.

Give the entries as they would appear on the books of both parties.

35. C needs funds. D, an associate of C, induces E to accommodate C. Accordingly, D introduces C to E, for which C pays $250. E discounts for C a note for $5,000 due in three months, and turns over to him $4,750.

Frame journal entries covering these transactions.

Cash Disbursements

36. Find the amount of cash disbursements from the following information:

The ledger accounts show the following balances: Capital $6,923.50; Merchandise, Dr. $5,041.30; Fixtures $950; Bills Receivable $1,740.80; Bills Payable $3,109.10; Accounts Receivable $2,266.90; Accounts Payable $1,179.30. No cash account is kept in the ledger. Cash receipts were $6,381.50. How much were the disbursements?

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